INSIDE THIS WEEK: A 14-PAGE SPECIAL REPORT ON ENTREPRENEURSHIP

The Economist

MARCH 14TH–20TH 2009

Economist.com

The jobs crisis

And what to do about it

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The jobs crisis
It's coming, whatever governments do; but they can make it better or worse: leader

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Politics this week

Mar 12th 2009
From The Economist print edition

PA

Northern Ireland threatened to return to sectarian violence after republican splinter groups staged two separate gun attacks that killed two soldiers and a policeman. Thousands gathered outside Belfast's city hall to protest against the threat to the decade-old peace process. Martin McGuinness, deputy first minister in the province's power-sharing government and a leading ex-member of the IRA, denounced the dissidents as "traitors". See article

President Nicolas Sarkozy confirmed that **France** would return to NATO's integrated military command, 43 years after Charles de Gaulle pulled the country out. A week before parliament votes on the move, he argued that it would not compromise France's strategic independence, but make it "stronger and more influential". A poll suggested that 52% in France approved.

A teenager in **Germany** shot and killed 15 people as he went on the rampage with a pistol at his former school near Stuttgart. He engaged police in a shoot-out at a car dealership and then apparently shot himself. In America a man went on a gun spree in **Alabama**, killing five relations and five bystanders before shooting himself. See article

Georgia pulled out of May's Eurovision Song Contest, to be held in Moscow, when its entry was banned for taking a potshot at Vladimir Putin, **Russia's** prime minister. The ditty was titled "We Don't Wanna Put In"; Mr Putin is apparently "killin' the groove".

The party's over

Brazil's economy shrank by 3.6% in the fourth quarter of 2008 compared with the previous three months, faster than expected and the worst quarterly performance for a decade.

Bolivia's president, Evo Morales, expelled an American diplomat whom he accused of conspiring to infiltrate the state oil company on behalf of the CIA. The United States dismissed the claim as baseless. The oil company's president, a senior figure in Mr Morales's Movement to Socialism, was recently sacked and arrested on suspicion of orchestrating a corruption racket. See article

Defence ministers from all 12 South American countries held an inaugural meeting of the **South American Defence Council**, set up to try to forge a common defence policy and share information about military spending in the region.

Power play

Getty Images

Hillary Clinton, **America's** secretary of state, and Yang Jiechi, **China's** foreign minister, held talks in Washington to pave the way for a presidential meeting between Barack Obama and Hu Jintao next month. The atmosphere was clouded by mutual accusations over an incident in the South China Sea in which America said one of its ships was harassed by Chinese vessels. See article

In a speech marking the 50th anniversary of the abortive uprising that led to his flight into exile, the **Dalai Lama**, Tibet's spiritual leader, made some of his harshest criticisms of Chinese rule in his homeland. He continued, however, to call for a "middle way" for Tibet, short of independence.

The publisher of a popular online newspaper in **Thailand**, *Prachatai*, was arrested after a reader posted a comment deemed offensive to the monarchy.

As South Korea and America conducted annual joint military exercises, **North Korea** complained bitterly and gave warning of the risk of a nuclear war.

Police in **Pakistan** arrested dozens of lawyers and opposition activists ahead of a four-day anti-government protest march calling for sacked judges to be reinstated. The beginning of the march was marked by violence.

A suicide-bombing in the south of **Sri Lanka**, which killed at least 15 people, was blamed on the rebel Liberation Tigers of Tamil Eelam.

A new age of reason

Barack Obama signed an order overturning a ban on federal funding for embryonic **stem-cell research**. The ban was brought in by George Bush in 2001 on moral grounds and was a touchstone policy for religious conservatives. Mr Obama said that America had been presented with a false choice between religion and science. See article

A $410 billion **spending bill** that sees the government through to the end of the fiscal year was signed. The bill contains measures that loosen restrictions on Cuban-American visits to family in **Cuba** and eases existing food and medical trade with the island.

Charles Freeman withdrew his nomination as head of the National Intelligence Council. The former ambassador to Saudi Arabia blamed carping from the Israeli lobby. And the hunt for a new surgeon-general intensified after the front-runner, **Sanjay Gupta,** a doctor and media star, said he didn't want the job.

Look who's talking

Egyptian mediators said the two main **Palestinian** factions were making progress towards settling their differences in the hope of eventually forming a unity government. Meanwhile, American emissaries met **Syria's** President Bashar Assad in Damascus and Britain said it would talk to **Lebanon's** pro-Syrian Shia party-cum-militia, Hizbullah. See article

Two suicide-bombings in **Iraq** killed at least 57 people, showing that the jihadist insurgency, though much weakened, is by no means over. The first attack hit a police academy in Baghdad; the second, three days later, struck at a meeting of tribal leaders in Abu Ghraib, a district to the city's west, where they were attending a reconciliation conference.

An **Iraqi journalist** who threw his shoes at George Bush on a visit to Baghdad last year was jailed for three years.

The wife of **Zimbabwe's** new prime minister, Morgan Tsvangirai, was killed when a car in which the couple were travelling was hit by a lorry. Suggestions that there had been foul play sounded implausible. President Robert Mugabe, with whom Mr Tsvangirai is now awkwardly sharing power, visited his rival in hospital and later spoke graciously about Mrs Tsvangirai.

EPA

Madagascar's political crisis deepened after pro-opposition soldiers forced the resignation of the head of the army. He had earlier given the country's political rivals, President Marc Ravalomanana and the opposition leader, Andry Rajoelina, 72 hours to settle a dispute that has brought the island to the verge of civil war.

Business this week

Mar 12th 2009
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There were more big mergers in the drug industry. **Merck** announced that it would buy **Schering-Plough**, its smaller New Jersey rival, for $41 billion. Merck will take on $8.5 billion in debt to help pay for the deal. And an offer by Switzerland's **Roche** for the 44% of **Genentech** that it does not already own was accepted by the American biomedical company's board. Roche will pay $46.8 billion after raising its offer for a second time. See article

Dow Chemical came to an agreement with **Rohm & Haas** in which it will now buy the specialty materials company. A court case brought by Rohm to force Dow to complete the deal was due to be heard this week. Dow tried to pull out of the acquisition when its financing for the transaction fell apart. Rohm's legal action was being keenly watched for any changes to the law regarding obligations to finish deals entered into before the start of the financial crisis.

Bernie Madoff was expected to plead guilty to charges relating to his Ponzi scheme, the biggest fraud in history. See article

A former banker and four others were convicted in the first trial for insider dealing in **Hong Kong**, which its Securities and Futures Commission hailed as a "landmark decision". The regulator had a busy week, also investigating whether traders were improperly shorting shares in HSBC.

Quarterly dividend

Vikram Pandit disclosed that **Citigroup** had a profitable first two months this year, and that, so far, the bank was turning in its best quarterly performance since 2007. Citi's boss divulged the information in an internal memo that was leaked, causing Citi's share price to rise from its death bed, having fallen to around $1. Mr Pandit's optimism spurred a rally in stockmarkets; the volume of trading in Citi shares was the fourth-largest on record.

Lloyds Banking Group joined the British Treasury's Asset Protection Scheme. The bank will place toxic loans worth £260 billion ($359 billion) in the scheme, most of them from HBOS, a distressed lender it took over in a government-backed rescue. Lloyds is also converting preferred shares it issued to the Treasury last year into ordinary shares. If investors do not subscribe to the offer, the government will buy the shares, raising taxpayers' stake in the bank.

The Bank of England's first action under its **quantitative easing** programme was deemed a success when its offer to purchase £2 billion ($2.8 billion) of government bonds was five times oversubscribed. The central bank aims to buy back £75 billion of gilts and corporate bonds to boost the supply of credit, in effect creating new money. See article

Do numbers matter any more?

Freddie Mac made a loss of $23.9 billion in the fourth quarter and said it would need an extra $31 billion from the government. Fannie Mae, its sister company, recently reported a quarterly loss of $25.2 billion. The companies account for 43% of America's home-mortgage market.

UBS said its net loss for 2008 was actually SFr1.2 billion ($1.1 billion) more than it had first stated, mostly because of its settlement with America's Justice Department over clients who avoided tax. The Swiss bank's restated loss for last year is SFr20.9 billion.

Neiman Marcus recorded a quarterly net loss of $509m for the 13 weeks to January 31st. Sales at the high-end store chain fell by 20% compared with a year earlier.

Standard & Poor's downgraded its AAA credit rating for **GE** and GE Capital, the conglomerate's finance

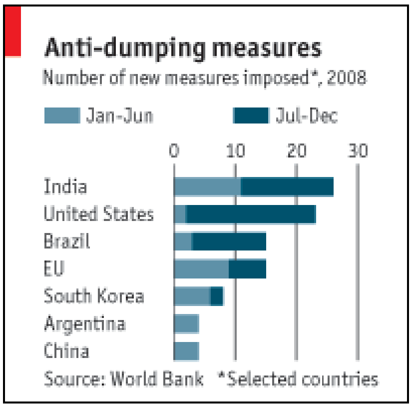
arm (which earlier sold $8 billion in government-backed debt). It is a blow to the company and Jeffrey Immelt, its boss. GE's share price has come under pressure amid speculation it would lose the rating, which it has held for over five decades. See article

Audi reported a rise of 30% in profit after tax for 2008, its best year for sales. Still, the German carmaker said it expects 2009 to be hard. **Volkswagen**, Audi's parent, recently posted a 14% increase in annual profit.

China's exports plunged again in February, by 26% compared with the same month in 2008. Imports fell by 24%. But there was some good news for carmakers. A cut in the tax on cars in China helped sales there climb by 25% in February. See article

Beggar thy neighbour

The World Bank forecast that the **global economy** is likely to shrink this year for the first time since the second world war. In a paper prepared ahead of a meeting of finance ministers and central bankers from the G20, the bank gave warning of a jump in world poverty if private-sector creditors continue to shun developing countries, which face a potential financing shortfall of up to $700 billion. The bank also said that the rise in protectionist measures imposed since the start of the credit crisis presented a "serious threat in the current environment". See article



KAL's cartoon

Mar 12th 2009
From The Economist print edition

Illustration by KAL

World economy

The jobs crisis

Mar 12th 2009
From The Economist print edition

It's coming, whatever governments do; but they can make it better or worse

Illustration by Belle Mellor

NOTHING evokes the misery of mass unemployment more than the photographs of the Depression. You can see it in the drawn faces of the men, in their shabby clothes, in their eyes. Their despair spawned political extremism that left a stain on society; but it also taught subsequent generations that public policy has a vital part in alleviating the suffering of those who cannot get work. Thanks to welfare schemes and unemployment benefits, many of which have their origins in those dark days, joblessness no longer plunges people into destitution, at least in the developed world.

Not even the gloomiest predict that today's slump will approach the severity of the Depression, which shrank America's economy by more than a quarter, and put a quarter of the working-age population out of a job. But with the world in its deepest recession since the 1930s and global trade shrinking at its fastest pace in 80 years, the misery of mass unemployment looms nonetheless, and raises the big question posed in the Depression: what should governments do?

Join the queue

In the rich world the job losses are starkest in America, where the recession began. Its flexible labour market has shed 4.4m jobs since the downturn began in December 2007, including more than 600,000 in each of the past three months. The unemployment rate jumped to 8.1% in February, the highest in a quarter-century. An American who loses his job today has less of a chance of finding another one than at any time since records began half a century ago. That is especially worrying when the finances of many households have come to depend on two full incomes.

But it is already clear that unemployment will strike hard far beyond America and Britain. In Japan output is plunging faster than in other rich economies. Although unemployment is low, rapid job losses among Japan's army of temporary workers are exposing the unfairness of a two-tier labour market and straining an egalitarian society.

In Europe joblessness has grown fastest in places such as Spain and Ireland, where building booms have crashed, but has only begun to edge up elsewhere. The unemployment rates in many European countries are below America's, but that may be because their more rigid labour markets adjust more slowly to falling demand. Given how fast European economies are shrinking, nobody doubts that worse lies ahead. By the end of 2010, unemployment in much of the rich world is likely to be above 10% (see article).

In the emerging world the pattern will be different, but the outcome more painful. As trade shrinks, millions of workers are losing their foothold on the bottom rungs of the global supply chain. Poverty will rise as they sink into informal work or move back to the land. The World Bank expects some 53m people to fall below the level of extreme poverty this year (see article).

Politics dictates that governments must intervene energetically to help. That's partly because capital has taken such a large share of profits for so many years that the pendulum is bound to swing back and partly because, having just given trillions of dollars to the banks, politicians will be under pressure to put vast amounts of money into saving jobs. But help cannot be measured in dollars alone. Badly designed policies can be self-defeating. After the recessions of the 1970s and early 1980s, Europe's rigid labour-markets kept unemployment high for decades.

Governments are piling in with short-term help for workers. In America, which has one of the lowest social safety nets in the rich world, extending unemployment benefits was, rightly, part of the recent stimulus package. Japan is giving social assistance to "non regular" workers, a group that has long been ignored. In general, however, it makes more sense to pay companies to keep people in work than to subsidise unemployment. Many countries are topping up the earnings of workers on shortened weeks or forced leave.

These are sensible measures, so long as they are time-limited; for, in the short term, governments need to do all they can to sustain demand. But the jobs crisis, alas, is unlikely to be short-lived. Even if the recession ends soon (and there is little sign of that happening), the asset bust and the excessive borrowing that led to it are likely to overshadow the world economy for many years to come. Moreover, many of yesterday's jobs, from Spanish bricklayer to Wall Street trader, are not coming back. People will have to shift out of old occupations and into new ones.

A difficult dance

Over the next couple of years, politicians will have to perform a difficult policy U-turn; for, in the long term, they need flexible labour markets. That will mean abolishing job-subsidy programmes, taking away protected workers' privileges and making it easier for businesses to restructure by laying people off. Countries such as Japan, with two-tier workforces in which an army of temporary workers with few protections toil alongside mollycoddled folk with many, will need to narrow that disparity by making the latter easier to fire.

The euphemism for that is "flexibility". The bare truth is that the more easily jobs can be destroyed, the more easily new ones can be created. The programmes that help today, by keeping people in existing jobs, will tomorrow become a drag on the great adjustment that lies ahead. As time goes by, spending on keeping people in old jobs will need to be cut, and replaced with spending on training them for new ones. Governments will have to switch from policies to support demand to policies to make their labour markets more flexible. That is going to require fancy political footwork; but politicians will have to perform those steps, because if they fail to, they will stifle growth.

However well governments design their policies, unemployment is going to rise sharply, for some time. At best it will blight millions of lives for years. The politicians' task is to make sure the misery is not measured in decades.

The London summit

The better part of valour

Mar 12th 2009
From The Economist print edition

The G20 summit in London is setting out to do too much. It should concentrate on what needs doing right now

Illustration by David Simonds

THE list that the leaders are drawing up for the G20 summit in London on April 2nd is an impressive one. All the items on it are problems that everybody wants dealt with. But this is not the time to talk of how to redesign regulation and predict future crises: this is the time to save the world economy and trading system. When the house is burning down you concentrate on putting out the fire, not on preventing future ones.

Cut to London

The London summit is a second act, after an emergency G20 get-together in Washington, DC, during the last months of the Bush presidency. That offered little besides vague reassurances—its most useful step was to include up-and-coming economies such as China, India and Brazil, as well as the has-beens in the G8. Since then the world economy has plunged into recession and governments have had time to work up their plans. A lot of people are banking on success in London (see article). Vague reassurances will not do.

Mindful of that—and his own weak position at home—Gordon Brown, Britain's prime minister, drew up an epic agenda. The summit should not only stimulate the economy and renounce protectionism, but also bolster the IMF and other international financial outfits, revamp regulation, create an early-warning system for crises, and save the poor. It was as if Mr Brown thought the ailing economy would yield to an act of governmental will, if only it were colossal enough.

But by overreaching itself, the summit looks likely to weaken the politicians' efforts. There is just too much to do in a day—especially because the Americans, understaffed and overworked, seem lamentably unprepared to take the initiative. A big agenda can give everyone something they want, but it can also give everyone something to disagree about. Americans are suspicious of the European desire for a system of global regulation that may threaten their sovereignty (see article); Europeans do not agree with American demands that governments spend yet more money—partly because they are worried about the size of the state (see article); Asians, who blame America and Britain for the crisis, do not want a souped-up IMF unless they have a greater say in how it is run. The summit may agree on minutiae like tax havens (none of which will be represented) and bankers' bonuses (nobody loses votes bashing bankers). But on the important stuff, the stage is set for disappointment.

The leaders in London should put other matters aside and devote themselves to the two things that matter most today. First is a beefed-up government stimulus. America is right to argue that private-sector demand has collapsed, leaving the public sector as the engine of the economy. Governments such as China's have spent freely (see article), but some could do more. One step would be to treble the IMF's resources, to $750 billion, so that it can give more help to emerging economies (the vexed question of how to run the fund can wait). Another is for countries to meet the IMF's call for a co-ordinated stimulus of 2% of world GDP. Not only would that be more effective, but it would also help mitigate the leakage of public spending abroad.

The second priority is to present a united front against protectionism. This does not just mean fine words. They are too easy to ignore. The London summit should promise tariff cuts and pledge to put aside the arsenal of legal trade protection, such as anti-dumping suits, which have been surging lately, and to ensure that subsidies do not discriminate against foreign companies. If the world's leaders could do those two things, they would be doing the best they can.

Barack Obama's foreign policy

All very engaging

Mar 12th 2009
From The Economist print edition

America's president has made a good start in foreign policy. But the hard choices are still to come

AP

FOR impeccable reasons, Barack Obama has concentrated since becoming president on fixing America's economy. On foreign policy, he has only sketched the outline. Soon, however, he must start to fill in some details. Early next month he goes to Europe for the G20 summit on the world economy, NATO's 60th birthday party in Strasbourg and a meeting with the European Union in Prague. He intends on the same trip to take in Turkey, thus fulfilling a promise to make an early visit to a Muslim country and start mending relations with the Islamic world. When he visited Europe as a candidate last summer, 200,000 Berliners cheered him to the skies. This time, he will be expected to put substance behind the magic.

So far, the outline at least is fine. Mr Obama has resisted the temptation to tear up every one of George Bush's policies, but he has transformed the tone. The fight against al-Qaeda is to continue, but without the preaching that alienated America's allies or the torture that betrayed its values. He is pulling out of Iraq, but on a cautious timetable. He is sending more troops to Afghanistan, but reviewing the strategy of a war he admits America is failing to win. He is extending his hand to adversaries, but without yet making America look like a soft touch.

This belief in "engaging" is so far the most visible element of the emerging Obama doctrine. Mr Obama, it seems, is not a man to push foes into a corner or stick rude labels on them, as Mr Bush did. Iran and Syria are no longer rogue regimes beyond polite society: the band formerly known as the "axis of evil" is being summoned to join the conversation. Iran may have armed the Taliban but is invited to a "big tent" meeting on Afghanistan. Syria may have ordered the assassination of a former prime minister of Lebanon, but Hillary Clinton, Mr Obama's secretary of state, has sent her officials to patch up relations with Bashar Assad. Russia invaded Georgia, but, hey, that was last summer. Now the NATO-Russia Council is to resume meetings and Mr Obama is renewing long-stalled talks with Russia on cutting nuclear weapons (see article).

Those who believe, as the neocons did, that the focus of foreign policy should be to promote liberal democracy, will find much to disapprove of. But a policy of pinching one's nose and engaging with malodorous regimes has its merits. It treats the world as it is, not as it should be, and it gives awkward customers a chance to change course and co-operate with America without losing face. To foreign-policy realists, that is a nice change from the with-us-or-against-us approach of Mr Bush's first term, when a lot of countries voted against.

Not just a nice guy, thank goodness

On the other hand, the test of a policy based on realism is whether it delivers results, and engagement on its own, as Mr Bush discovered in his chastened second term, seldom alters the behaviour of regimes that think they are acting rationally in their own vital interests. Look at North Korea, still threatening war after diplomats have spent bottom-numbing years in talks (see article). Or at Iran, which talked and talked to well-meaning Europeans but still insists on its nuclear "rights" (ie, the right to get within a screwdriver's turn of a bomb). Talk, even from a president as winning as Mr Obama, needs to be accompanied by some hard-edged diplomacy.

Has Mr Obama got the necessary hardness? So it seems. His decision to reinforce the war in Afghanistan while scaling down in Iraq shows that he is not afraid to use America's military power (though we think he should have stopped America's counterproductive air raids on terrorists in Pakistan). He recently told Russia that if it helps stop Iran going nuclear, America might drop the plan Russia loathes to station missile defences in Poland and the Czech Republic. This points to a diplomacy based on a shrewd trading of interests, not—despite all that disarming courtesy—a naive faith that noxious regimes will show goodwill just because they are treated with respect.

What remains unclear is not whether Mr Obama is clever or tough. It is his basic reading of the world. Does he see China more as a rival than an ally? Too soon to say. Is Afghanistan winnable? Watch that review. Is Palestine solvable? Mrs Clinton's recent visit, showing sympathy but changing no policy (Hamas remains beyond the pale), leaves the question dangling. Will he risk pre-emption against Iran or does he believe it can be contained? The mullahs would love to know.

The first big clue to Mr Obama's instincts may come in his treatment of Russia. A few months ago it looked as if the NATO meeting in April would take place in the shadow of a Russia still in macho mode after the Georgia war and confident of bobbing to riches on oil and gas. To its own surprise, Russia is now a casualty of the world recession.

This does not make America's policy simpler. A Russia with a wrecked economy may become even less congenial. Mrs Clinton speaks of "managing" differences where they persist, while standing firm on principles and vital interests. But what if interests and principles collide? America says Russia has no right to bully neighbours such as Georgia and Ukraine. But Russia can offer vital help on Iran. So far, Mr Obama has not had to confront these hard choices. Soon he will.

Sudan

Compounding the crime

Mar 12th 2009
From The Economist print edition

The case against Omar al-Bashir has opened a fissure between those who support justice and those who fear it

Reuters

GIVEN the history of the Sudanese government's brutal treatment of the population of Darfur, some adverse reaction to last week's indictment of President Omar al-Bashir by the International Criminal Court (ICC) was expected—but nothing quite as bad as what happened. A dozen major international aid agencies and a couple of local ones were immediately expelled from Darfur, and many from the country altogether; staff were unceremoniously escorted to waiting planes while their computers, files and much else were confiscated by the authorities. The remaining aid agencies have been put on notice, and could be next.

The NGOs that were expelled from Sudan provided much of the food, water and medicine to the 2.75m refugees who live in temporary camps in Darfur. So this move is, above all, a huge blow to the fragile humanitarian lifeline that has been keeping the wretched victims of the Darfur conflict alive. By some estimates, the NGOs that have been kicked out contributed 80% of the workers who distributed the World Food Programme's aid in Darfur—the people, that is, who actually gave the food to the refugees in the camps. They also maintained boreholes and water pumps in the camps. Without clean water, diseases are likely to spread quickly. Meningitis has already struck one camp.

The Sudanese government has given no official explanation for the expulsions, but has made spurious allegations that all these aid agencies were involved in a conspiracy to supply the ICC with the evidence to prosecute Mr Bashir and his henchmen. More to the point, the Sudanese government evidently has no backup plan to replace the vital services the NGOs provided. Although it is clear that the expulsions were planned carefully in advance, it is equally clear that no thought was given to who would do the expelled workers' jobs instead. This makes the action doubly callous. As usual, it is the ordinary Darfuris who will bear the burden of the government's vindictiveness.

Since 2003 about 300,000 people have died as a result of the fighting in Darfur. Before more do, the world should therefore push hard to make Sudan reverse its decision. At the very least, Mr Bashir should be pressed to let the 2,000 or so Sudanese nationals who worked for the expelled aid agencies be re-employed by the smaller NGOs that remain. Their expertise could save the lives of thousands of Darfuris. If the government does nothing, and thus causes even more deaths, they should be added to Mr Bashir's charge-sheet.

Not enough just to say "should"

Yet the attitude of many countries over the past week to the ICC's indictment has been worse than disappointing. Many have expressed dismay at the ICC's decision and yet said nothing about the expulsion of the aid agencies. China, long Sudan's main backer, blocked a mere press statement from the UN Security Council that would have condemned Mr Bashir's government for the move. Such countries say they want the Security Council to defer the ICC's indictment, on the ground that seeking justice against Mr Bashir will upset the "peace process" in Darfur. They would have a reasonable point if there were indeed a genuine peace process under way which the indictment would jeopardise. But Mr Bashir has long since emptied the process of meaning. His government has done nothing to bring any of the mass killers to justice. In these circumstances, the ICC has become the last resort.

Mr Bashir's cry that the ICC is a weapon of Western "neo-colonialism" has gone down well with some African governments, many Arab leaders and Iran. Not all African countries have rallied to his support, however. Sierra Leone, for instance, which experienced horrors rather like Darfur's, has become a strong proponent of justice and a firm believer in the part it must play in ending conflicts. Most African governments subscribe to a "peer review" mechanism that invites them to judge each other's human rights records. Few, unfortunately, take this seriously.

The court's decision gets more support from ordinary people. Darfuris themselves are well aware of how they might be punished for backing the ICC; yet, despite the indictment of two Darfuri rebel leaders along with members of the government in Khartoum, it is hard to find anyone aside from Mr Bashir's few Arab supporters in the main towns who opposes the court's action. Justice matters even—perhaps especially—to people who have nothing.

Now that Mr Bashir has compounded his original crime, it is all the more important that he should be put in the dock. To get him there, countries that believe in justice must throw all their political weight behind the indictment. Some poor-country governments, fearful that they too might one day be held to account for their actions, will inevitably attack this as "neo-colonialism". Too bad.

Cap and binge

Mar 12th 2009
From The Economist print edition

America's politicians are at last getting to grips with global warming, but in a dangerously expensive way

EPA

THE power plant that heats Congress produces more carbon dioxide than any other facility in Washington, DC. It is almost 100 years old and runs partly on coal, a grubby fuel. Last week, protesters marched on it, urging Congress to cut its own emissions of greenhouse gases and to oblige the rest of America to do so as well.

The first demand was easily met: the leaders of the House of Representatives and the Senate instructed their staff to convert the plant to run on natural gas, which burns more cleanly than coal. But the second one is proving trickier. Congress is just beginning to grapple with laws to regulate greenhouse gases (see article), at the behest not just of protesters but also of Barack Obama, who has long advocated vigorous measures to curb global warming. Bringing about a wholesale change in America's energy supply will be a challenge, to say the least. And the sort of measures that are currently finding favour in Washington will make it harder still.

The president is right to want to cut emissions. The alternative, allowing climate change to take its course, would be far more damaging to America and the world. The economic impact of rising sea levels, reduced crop yields, fiercer storms and many other doleful consequences would be devastating.

But fighting climate change will be costly. It will involve swapping cheap but dirty fuels for cleaner but dearer ones, as Congress intends, as well as building lots of expensive new power plants to replace older, more polluting ones. That in turn will lead to higher electricity and fuel prices. Despite the president's airy talk of green jobs, cutting emissions, by almost all calculations, will increase costs for most businesses and families. Those extra costs must be kept to a minimum.

Mr Obama's preferred device for cutting emissions, a cap-and-trade scheme, is designed to do just that. It involves placing a limit on the volume of emissions that can be produced around the country each year, and then auctioning tradable permits to pollute. The intention is to encourage firms that find it cheap to cut emissions to do so, while allowing those with no easy means to pollute less to buy permits instead. Politicians and bureaucrats, meanwhile, do not need to identify where emissions cuts should be made; the market takes care of that for them.

Sunshine and moonshine

Many congressmen are unconvinced. There is a general worry that the required emissions cuts will be harder than expected to find, pushing up the cost of the permits and thus flattening an already slouching economy. And there are particular fears that, even if the system works well enough overall, states that rely heavily on coal, heavy industry or some other sooty activity will suffer badly.

Both the president and cap-and-trade's supporters in Congress seem inclined to respond with subsidies for pet technologies that might help those hardest hit, or with mandates to cut emissions in particular ways. The president, for example, wants to double the amount of electricity that comes from renewables, meaning wind farms, solar-power plants and the like. Handouts for hybrid cars and for coal plants with low emissions are also popular.

The main effect of these schemes would be to raise the costs of cutting emissions. Much of the money doled out by the government would inevitably be wasted, adding to the overall bill for fighting climate change. Worse, such measures would risk distorting the carbon market, steering private capital as well as public money away from the cheapest technologies and towards those that have caught the eye of the politicians.

Under the stimulus bill, renewables benefit from a tax credit, grants, loan guarantees and an expensive overhaul of the electric grid. No wonder that each tonne of emissions avoided thanks to the measures in the stimulus to encourage renewable energy would cost somewhere between $69 and $137, according to a recent study. Under a cap-and-trade scheme, the price would be less than $15 to begin with, by most accounts.

There are some green things on which the government could usefully spend money. Investments in energy efficiency—of which the stimulus package included a lot—are particularly worthwhile. Increasing the budget for advanced scientific research may yield technological breakthroughs. But on the whole, government intervention is only likely to raise the cost of mitigating climate change. Fat handouts may make the politics of going green easier in the short run, but in the long run they will make it harder.

Northern Ireland

Just when you thought it was safe

Mar 12th 2009
From The Economist print edition

A spate of killings must not block the path to full power-sharing

AP

IT LOOKED like a scene from the bad old days. Two British soldiers at a base in Antrim took delivery of a last pizza before deploying to Afghanistan and were mown down in the street. A Northern Ireland police officer answered a call in Armagh and was shot in the back of the head. The killings were claimed by dissident IRA groups who believe, or pretend to, that the mainstream movement sold out its republican heritage in doing a deal with the unionists, to say nothing of the British. A shudder ran round the province at the thought that the Troubles might not, after all, be over.

Yet the striking thing is not that uniformed men once again lie dead in the streets of Northern Ireland, though the Good Friday agreement in 1998 supposedly put paid to politically motivated violence. It is that the people of the province, not least the leaders of its main parties (after a gulp on the part of Sinn Fein), united to condemn the killings. The most moving sight of the past week, after the grief of the bereaved families, was that of Peter Robinson, the Democratic Unionist first minister, Martin McGuinness, the Sinn Fein deputy first minister and former IRA strongman, and Sir Hugh Orde, the English boss of the Northern Ireland police, standing shoulder to shoulder outside the Northern Ireland Assembly at Stormont (see article). In vigils across the province, thousands showed their dismay at the resumption of violence.

The hand of history

The vast majority in Northern Ireland support the peace process. Most have benefited from the increased prosperity it has brought. Devolved government returned to the province in 2007, and old enemies are learning to work together. The killers have nothing like the glamour or support that the old IRA did; they are pipsqueak diehards, some of them soaked in garden-variety crime. All this suggests that the outbreak of violence may be a tragic blip.

But grievances in Northern Ireland run centuries-deep. The transformation of IRA leaders into Sinn Fein politicians does not mean the end of militant republicanism. Loyalist paramilitaries, still armed to the teeth, may seek to even up the body-count. Trust between old antagonists, on which power-sharing rests, is fragile. And there are two particular reasons for concern just at the moment.

The first has to do with security and intelligence. Although the IRA dissidents appear to have little support, it doesn't take many men with arms and experience to wreak havoc. The police have been well

enough informed to foil any number of attempted attacks over the past few years. More recently, however, Sir Hugh gave warning that the terrorist threat was growing and asked (controversially) for backup from military intelligence. He was right, it seems, to worry about the capacity of his police service—smaller and less experienced than the Royal Ulster Constabulary that it replaced—to contain the situation. The assault on the army base was not foreseen, even though, guarded by poorly armed civilians, it was a soft target.

The economic slump is a second worry. The peace process has been tacitly predicated on economic growth. Unemployment fell, new businesses multiplied and house prices soared after 1998. This is now changing. Northern Ireland’s economy is boosted by a big public sector and by Irish shoppers who flock north to buy Pampers priced in newly cheap pounds. But the public sector too will be trimming its workforce. The growing number of those with nothing better to do may find it tempting to join the political malcontents.

The best response is not to put British soldiers back on the streets (though their bases do need proper guarding); such a potent symbol of a jackbooted Britain is just what the dissidents need to give them substance. It is to carry on undeterred with the peace process and to strengthen Northern Ireland’s own police service, the central pillar of power-sharing.

This will require concrete measures. On March 11th the British Parliament passed a law paving the way for devolution of responsibility for policing and criminal justice to Stormont. The Northern Ireland Assembly must now vote in favour if it is to be implemented. Sinn Fein is committed to doing so; the Democratic Unionists have been slower to accept this deeply symbolic transfer of authority from Britain, insisting on further proofs of loyalty from their partners in power. Substantial help from former members of the IRA as the police run down the dissident killers would serve everyone’s interests.

On transparency, sex education, Latvia, California, needles, Kenya, manufacturing

Mar 12th 2009
From The Economist print edition

Shining some light

SIR – Certain assertions in your article on transparency in financial markets deserve to be reconsidered (Economics focus, February 21st). You describe transparency as amorphous, criticise it as costly and say it takes second place to trust in the money markets. It is hardly surprising that shortcomings may arise from inaccurate, immaterial and incomparable publicly available information, but transparency as a principle cannot be blamed. A hefty prospectus veiled in legal jargon should not be considered a transparent tool of disclosure; it is a means of obfuscation. The sheer complexity of repackaging subprime loans to achieve AAA credit-ratings is indicative of efforts to deceive through disguise.

Trust in financial markets vanished when the lack of transparency became apparent; it is only through transparency that investor confidence and public trust can be won back. As for "symmetry", some investors will always be able to use information better than others, but this information should be available to all. Transparency leads to a level playing field.

The failure of the markets has resulted in massive bail-outs. By comparison, the costs of disclosure in well-regulated markets are borne by all those who promote a risk, or transfer it to others. From preventing excessive short-term risk-taking to exposing potential conflicts of interest, transparency is key to ensuring that confidence is restored.

Huguette Labelle
Chair Transparency International
Berlin

We are all only human

SIR – I read the comment in your article on sex education in America that "abstinence-only education programmes have been controversial ever since they were introduced under Ronald Reagan in 1981" ("Just say no", February 14th). It is about time that Reagan's sex-education policies were reversed. They have been a disaster, responsible for both the spread of disease and an increase in unwanted pregnancies and abortions in America, even more so in Africa. However, you should have pointed out that Reagan himself wasn't maybe the best exemplar of his policy, having got Nancy pregnant before he married her.

Robert Sarver
Northville, Michigan

Latvia's economy

SIR – Your briefing on eastern Europe's economies mentioned that Latvia's IMF-supported programme entails large cuts to social spending ("The whiff of contagion", February 28th). That is inaccurate. Although it is true that the fiscal consolidation planned by the Latvian government is indeed large, at around 7% of GDP, social spending, as well as capital spending co-financed by the European Union, is explicitly protected. In fact, according to data provided to the IMF, spending on social support programmes is planned to increase between 2008 and 2009 in absolute terms, as a percentage of GDP, and as a share of total outlays.

Pensions will not be changed this year and will be indexed to inflation next year, at the same time as public-sector employees are set to see substantial reductions in their nominal salaries. Under the

programme the Latvian authorities will also improve the targeting of spending to develop social safety nets. This is consistent with the objective of increasing competitiveness under Latvia's fixed exchange-rate regime, while also protecting those who are most vulnerable.

Christoph Rosenberg
Mission chief for Latvia International Monetary Fund
Washington, DC

SIR – You say that Latvia has enjoyed a colossal boom "fuelled by reckless bank lending, particularly in construction and consumer loans". You then state that "conventional wisdom would have suggested applying the brakes hard, by tightening the budget and curbing borrowing. But the country's rulers, a lightweight lot with close ties to business, rejected that."

Hang on a minute. That sounds remarkably like the ten years leading up to the recession in Britain. I'm no expert on Latvian economic history but it seems rather harsh to blame Latvia's rulers, who were probably doing no more, in their new-found freedom, than emulating what they doubtless perceived as the conventional wisdom of Western capitalist policies.

Gina Antczak
Lymington, Hampshire

A city on a hill

SIR – If I were to catalogue all the falsities in Lexington's column (February 28th) excoriating California and San Francisco my letter would be far too long for publication, so I'll stick to what I know from personal experience. First, it is not congressional Democrats who have given our state "the most dysfunctional politics in the country", it's our muscle-headed Republican governor, and a cabal of dogma-clinging Republican legislators.

Next, as a middle-class San Franciscan—I am a high-school instructor and my wife is a librarian—happily raising children here, surrounded by other middle-class folks doing the same, I can assure you that my city is not "a playground for the ultra-rich and a sewer for the poor". Finally, it is absurd to suggest that Nancy Pelosi, the speaker of the House of Representatives, is more isolated from the "real" America than the Texan suburbanites she replaced just because she has a house in Pacific Heights. For one thing, it is about a ten-minute walk from her house to my daughter's school, which is 50% African-American.

Anyway, if I have to choose between "Californication" and whatever it was that those Texans were doing to us for the past eight years (I don't even want to try to think of a word for it) I'll take our way a dozen times over.

Erik Honda
San Francisco

SIR – I am a politically moderate homeowner in San Francisco, married with children. Property prices here are mind-bendingly expensive, but the vast majority of people are middle class. Besides, if California is such an undesirable place then why have business giants such as Apple, Gap, Genentech, Google, Intel and Oracle, to name just a few, started here?

Shannon Holloway
San Francisco

SIR – I must protest at the photograph of California's governor in your article on the state's fiscal crisis ("The ungovernable state", February 21st). The laws of physics will simply not permit Arnold Schwarzenegger, even as the Terminator, to carry a coffin, empty or otherwise, on one shoulder while the position of his body is, as shown, vertical. He would simply fall over to his left, unless his body curved rightward to ensure his combined centre of gravity remained within the area defined by his feet.

Perhaps the photo was used to illustrate that he is, indeed, falling to his left under the burden of unsustainable social and pork-barrel spending. Alternatively, the "coffin" is no more than an empty polystyrene box designed to deceive Californians into believing he has got firm control of the dead weight the state imposes on its beleaguered taxpayers, and that the budget is as firmly balanced as he is. Either

way, it augurs ill for Californians.

Tony Allwright
Killiney, Ireland

The following letters appear online only

Needle point

SIR - Regarding your article on needle-exchange programmes in Britain, we believe that you made an unreasonable comparison between services for people who inject illicit drugs and people who are living with diabetes ("Yes to heroin, insulin no", February 28th). First, those who need to inject often do not routinely use normal needles and syringes. The 5-15% who are type-one and need to inject often do not routinely use "normal" needles and syringes. The tendency is to use a NovoPen or similar device and the needle is usually disposed of by clipping (a device something like a cigar-cutter snips the needle off). People with diabetes therefore do not require regular access to a source of sterile injecting equipment and sharps disposal as, for example, a speedball user who may be injecting 20 times a day or more.

Second, from a public-health perspective, people who inject insulin are a far lower risk group for blood-borne viruses such as HIV and hepatitis, particularly hepatitis C. Estimates indicate that approximately 85-90% of those with hepatitis C in Britain acquired the virus through injecting illicit drugs. Although the prevalence of HIV among injecting drug users in Britain is low compared to many other European countries there are concerns that it may be rising. In addition to the concerns about rising rates of blood-borne viruses among illicit-drug users, there is a strong correlation between illicit-drug use and crime, homelessness, health inequality, isolation from health services and chaotic lifestyles.

Needle and syringe programmes represent an important way to try to engage this disenfranchised group. People who inject insulin, on the other hand, tend to be in close contact with health services. The requirement to obtain insulin via prescription ensures at least some engagement with health professionals, and in fact the majority of people living with type-one diabetes have access to a wide range of specialist service provision.

Third, it is important to note the context in which NICE produces its guidance. The piece of guidance in question was produced in response to a specific referral from the Department of Health and it sets out to provide specific guidance on this topic. People living with diabetes who inject insulin are not covered by the recommendations in this guidance. To date, NICE has not been asked to produce guidance on the provision of injecting equipment and sharps disposal to people living with diabetes.

Professor Mike Kelly
Director
Centre for Public Health Excellence

Chris Carmona
Public-health analyst
National Institute for Health and Clinical Excellence (NICE)
London

Corruption in Kenya

SIR - I would like to respond to your review of a book by Michela Wrong on Kenya ("How to ruin a country", February 28th). Despite Ms Wrong's charges to the contrary, Britain's Department for International Development (DFID) has zero tolerance for corruption in Kenya and globally. Corruption hits poor people hardest, and undermines development, the rule of law and investor confidence. The best checks on corruption are strengthening governance and supporting citizens to speak out against it.

DFID's programme in Kenya does just this, including assisting groups that investigate the way Kenyan taxpayers' money is spent, such as the National Taxpayers' Association and Transparency International (previously headed by John Githongo, with whom we still work closely).

During the period highlighted in Ms Wrong's book, DFID officials worked with the British high commission

in Nairobi on the aid programme, British law-enforcement efforts and British visa exclusions for suspect Kenyan politicians. The notion that DFID officials sought to undermine anti-corruption efforts is nonsense.

More needs to be done. Ordinary Kenyans are increasingly vocal in demanding high-level prosecutions and an end to the culture of impunity in their country. The British government remains fully committed to supporting them to tackle the misuse of public money. I would challenge your reviewer, and Michela Wrong, to suggest constructive alternatives to the policies we are currently pursuing to combat corruption in Kenya.

Ivan Lewis, MP
Department for International Development
London

What to make of it all

SIR - As the boss of a British manufacturing company, you may be surprised that I support your leader warning against government intervention in manufacturing ("The collapse of manufacturing", February 21st). Our company has grown over the years but now, like so many others, is being affected by the global slowdown.

However, I will not join the clamour for sectoral state aid or add to the nationalistic drum beat from some in the media and industry for increased economic protectionism. My experience is that specialism, innovation, long-term investment and bright ideas will win through where protectionism and navel gazing will fail.

There is one area where government support is welcome however. I would appeal to the government to use this opportunity, and any future proposed stimulus packages, to boost investment in R&D, apprenticeships, training and other measures that will allow British manufacturers to gain their own competitive advantage by competing on "value creation" rather than "low cost" and avoiding commoditised product/market sectors, which will help shield them and us from future economic woes.

Keith Attwood
Chief executive
e2v
Chelmsford, Essex

SIR - You stated that "half-empty freighters are just one sign of a worldwide collapse in manufacturing". Could you not have said instead that the freighters were half full? A little bit of optimism from your newspaper might be just what our consumer confidence needs.

Ana Correa
London

America and climate change

Sins of emission

Mar 12th 2009
From The Economist print edition

Barack Obama is keen to curb greenhouse-gas emissions with a cap-and-trade scheme. Can Congress come round to his way of thinking?

Corbis

AS HE clinched the Democratic nomination for president last year, Barack Obama declared: "This was the moment when the rise of the oceans began to slow and our planet began to heal." Not yet two months into his term, despite lots of other pressing concerns, Mr Obama has taken on the task of tackling global warming with zeal (although the oceans nonetheless continue to rise: see article). He has increased government spending on environmental causes, instructed civil servants to increase the fuel-efficiency of America's cars, promised to double America's output of renewable energy and urged Congress to pass the greenest measure of them all: a cap on the country's emissions of greenhouse gases. Could Mr Obama live up to his grand green rhetoric?

There is no questioning his enthusiasm. He has appointed ardent advocates of emissions-cuts to senior jobs, including secretary of energy and head of the Environmental Protection Agency (EPA). Many of his appointees, such as Carol Browner, who is charged with co-ordinating policy on climate and energy, are veterans of the Clinton administration, which agreed to cut emissions under the Kyoto protocol but could not muster enough support in the Senate to get it ratified.

The administration has dedicated roughly a tenth of the $787 billion to be spent under the stimulus bill to energy and the environment, making it "the biggest energy bill the country's ever seen", according to Miss Browner. That includes $33 billion to green the country's electricity supply, $27 billion for energy efficiency and $19 billion for cleaner forms of transport. Voguish technologies such as renewables (meaning windmills, solar panels and the like), high-speed rail, carbon capture and storage, advanced batteries, "smart" electrical grids and plug-in hybrid cars all received big dollops of cash.

In his first budget, too, Mr Obama has proposed spending more on greenery. The EPA would receive a third more than it did last year. Some of that is slated for closer monitoring of greenhouse gases. The Department of the Interior would get more money to assess the potential for renewable energy and to protect endangered species from global warming; $150 billion would go towards improving green technology over the next decade.

Meanwhile, Mr Obama has directed the EPA to produce tighter fuel-efficiency standards for cars and to

reconsider its refusal under Mr Bush to allow California to regulate greenhouse-gas emissions from cars. The EPA is also wondering whether to overturn another decision from Mr Bush's day and regulate greenhouse-gas emissions itself. That, in effect, would allow it to set emissions standards for new power plants, and also to raise fuel-economy standards for cars beyond the levels required by existing laws.

All this, says Miss Browner, would complement Mr Obama's broader ambition to tackle global warming through a cap-and-trade scheme, whereby the government would set steadily declining annual limits on emissions, and would then auction permits to pollute up to that level. The president has consistently called for such a scheme, most recently in his first address to Congress, and even included revenues from permit auctions in his budget projections. Ideally, officials say, they would like to see cap-and-trade enacted this year, in time for a United Nations summit in Copenhagen in December, where negotiators hope to agree on a new treaty to stem global warming.

Congress seems receptive to the idea. The leaders of both the House of Representatives and the Senate have promised to allow a vote on cap-and-trade this year. The relevant committees in both chambers have said they will produce draft bills soon. The increased Democratic majority in both houses bodes well, since Democrats are keener on environmental measures, on the whole, than Republicans. But Environment & Energy Daily, a website that follows congressional wrangling on the subject, reckons there is not yet a majority in favour of cap-and-trade in either chamber. In the Senate, where 60 out of 100 votes are needed, it counts only 47 probable supporters and 21 fence-sitters.

The odds of winning over the waverers depend on the details of a cap-and-trade bill. But provisions designed to appeal to one lot might put off others. One of the most hotly disputed questions is what to do with the money earned by selling emissions permits. Some congressmen want it spent on the industries and households hardest hit by the rises in fuel and power prices that cap-and-trade will inevitably bring. Others want it spent on research into and subsidies for cleaner forms of energy. Yet others fear that the government will squander its takings, and so propose returning the money to citizens in the form of tax rebates or cuts, an idea known as cap-and-dividend. The president proposes a mixture of all three approaches.

The role of administrative measures is also up in the air. Mr Obama has repeatedly argued that it would be better for Congress to take charge of emissions than for the EPA to regulate them under the Clean Air Act, as the Supreme Court has said it can. But while Congress ruminates, the EPA is going ahead with measures that will have a bearing on emissions from vehicles in particular. Some congressmen might prefer to leave the reduction of emissions from transport up to the bureaucrats at the EPA rather than be seen to increase the price of driving—a red rag to many voters.

The volatility of carbon markets is another worry. In recent months the price of an emissions permit in the European Union, where a cap-and-trade system has been up and running since 2005, has reached a peak of over €30 and a trough of less than €10, thanks to the sour economic outlook. Analysts fear that such wild swings will make businesses reluctant to invest in low-carbon technology.

One solution is to adopt a tax on carbon instead of a cap-and-trade scheme. But that idea has little support in Congress, despite endorsements from Al Gore, America's climate-crusader-in-chief, Exxon Mobil, its biggest oil firm, and this newspaper. Alternatives doing the rounds include setting reserve prices for emissions permits at auction and creating a "Federal Reserve of carbon", which would manage the supply of permits—or try to—much as its namesake manages America's money supply.

Up in smoke

By far the most common concern, however, is that the price of carbon emissions will rise too high, and so cripple the economy. Many Republicans denounce cap-and-trade as a "stealth tax". PointCarbon, a consultancy, calculates that Mr Obama's plan would raise fuel prices by 6% and power prices by 7% on average in 2012, and by gradually increasing amounts thereafter. At a time when the economy is shrinking and hundreds of thousands of jobs are being lost, any law that would add to the woes of firms and families is bound to be a tough sell.

Moreover, higher energy costs would be unevenly spread. States with lots of heavy industry, and especially those where coal fuels most power plants or provides lots of mining jobs, will suffer most. Many of the waverers in the Senate come from such states, primarily in the Midwest; much of the congressional leadership comes from coastal states with less to lose.

The “Gang of 15”, a group composed mostly of wary Midwestern senators, say they will not vote for cap-and-trade unless their concerns about the economic impacts on their constituents can be assuaged. They might be mollified by a generous slug of auction revenues for their states, or a mechanism to cap the price of permits, or a rule that allowed extensive use of cheap international offsets in lieu of emissions cuts at home. But those fixes would upset both fiscal conservatives and environmental hawks.

In theory, the cap-and-trade system automatically minimises the cost of reaching any given emissions target, by allowing whichever firms can reduce their emissions most cheaply to do so on behalf of others, using whatever technology they like. But neither Mr Obama nor the Democratic leadership in Congress wants to leave things entirely to market forces. They all support the idea of obliging utilities to generate a certain proportion of their output—perhaps 15% by 2020—from renewable sources, for example, and want such a rule included in a cap-and-trade bill.

As several sceptical congressmen have noted, this “renewable portfolio standard” is redundant at best, in so far as utilities constrained by an emissions cap would choose to invest in renewables anyway. At worst, it will oblige utilities to invest in renewables when there are cheaper low-carbon alternatives available, and so add to the cost of cutting emissions. Ed Markey, the chairman of a House committee that focuses on climate change and energy security, disagrees. He wants to force utilities to invest not only in renewables, but in energy efficiency too.

The president and Congress are also keen to complement cap-and-trade with subsidies of various kinds. The main beneficiary, again, is renewable electricity. The stimulus bill extends the life of an existing tax credit for investments in it. It also allows developers to swap that credit for a grant from the government, since the credit is of use only to firms that are making taxable profits—a rare thing these days. In addition the bill sets aside $6 billion for loan guarantees for renewable projects, to add to the money originally allocated for the same purpose in 2005, but never used, and further funds proposed in the latest budget. On top of all that, the stimulus allocates billions to upgrade the grid, a step that will help bring power from remote wind farms and solar plants to big cities.

Most of these measures would be unnecessary if a cap-and-trade scheme were in place. Extending the tax credit, for example, would stimulate only slightly more investment in renewables than a cap-and-trade bill, at greater expense to the government, according to a recent study by the Peterson Institute for International Economics and the World Resources Institute, two think-tanks. Unless most subsidies for renewables are phased out once a cap-and-trade system is in place, says Paul Bledsoe, a former adviser on energy to the Clinton administration, they risk creating a boondoggle akin to the proliferation of incentives for corn ethanol. If taken too far, such handouts tend to become a crutch rather than a leg-up, and can end up sapping public support for the policy.

The Department of Energy’s loan-guarantee scheme certainly has the potential to create a bonanza. The $6 billion budgeted should allow it to back loans worth $60 billion, assuming a default rate of around 10%, says an official. That, in turn, should prompt $120 billion in investments. This comes on top of $10 billion in loan guarantees for renewables initially authorised by the Energy Act of 2005, but not yet disbursed. Guarantees are also on offer for new nuclear plants and coal plants with low emissions.

The department says it aims to pick projects in as transparent and objective a manner as possible, and to concentrate on projects that were well advanced, but collapsed when finance dried up as a result of the credit crunch. But those, arguably, are the least in need of government support. And with such a lot of money to spend, the bureaucrats will need to cast their net quite widely.

In general, the emissions cuts picked by politicians are far more expensive than those chosen by the private sector. The study by the two institutes puts the cost of every tonne of emissions avoided thanks to the provisions of the stimulus bill at somewhere between $69 and $137. PointCarbon, by contrast, estimates that the carbon price under the sort of cap-and-trade bill the president envisages will be roughly $13 a tonne.

Congress is unlikely to swallow the castor oil of cap-and-trade without such sweeteners, Washingtonians say. But the more lavish the subsidies, the more expensive cutting emissions becomes—and the harder for voters to stomach.

The economy

Pursued by Obamabears

Mar 12th 2009 | WASHINGTON, DC
From The Economist print edition

Investors fret that President Obama's crisis response is not up to the task

Illustration by David Simonds

BARACK OBAMA has modelled his early days on those of Franklin Roosevelt, the last president to take office during a serious economic crisis. But by one benchmark he is failing. At market close on March 11th, despite a rally this week, the Dow Jones Industrial Average was 16% below its level on the Friday before Mr Obama took office. At this point in Roosevelt's presidency, 54 days in, it was up 35%.

The "Obama bear market," as conservative commentators have gleefully labelled it, has been blamed on two things: on the new president trying to do too much, and on his failure to do more. There is, paradoxically, truth to both assertions.

Conservatives have attacked Mr Obama's budget proposals as a wealth-destroying combination of increased government intervention and higher taxes. In truth, he had long promised to spend more on health care and alternative energy and to raise taxes on the rich, so little in the budget should have surprised investors.

A bigger dent to confidence comes from Mr Obama's style, not his substance. His many backers on Wall Street had taken his conciliatory manner and selection of centrist economic advisers as evidence that he would govern moderately despite, as a senator, having consistently voted on the left. They have been taken aback by his combative tone. On February 28th, for instance, he declared that "special interests and lobbyists" were "gearing up for a fight [and] so am I." Earlier, he said bankers could not take their bail-out money and "pad their paychecks or buy fancy drapes or disappear on a private jet." Bankers fear this demonisation is driving down their share prices. Confidence has also been rattled by plans to pass a bill letting unions organise without a secret ballot.

But the Obamabears' biggest fear is that Mr Obama's remedies are not up to the task of fixing America's deepening recession. To be sure, Mr Obama's team has had a huge $787 billion stimulus package passed, begun evaluating banks' need for more government capital, and unveiled a plan to reduce mortgage foreclosures. But in the meantime, the outlook has deteriorated sharply and the administration has still not decided how to get bad loans off banks' balance sheets. Andrew Grove, the former chief executive of Intel, the world's biggest microchip-maker, advised Mr Obama this week to "rein in the chaos" of differing financial fixes before moving on to health care and energy. Critics say Mr Obama is trying to do too much at once.

Administration officials appreciate the urgency for action. In his budget, Mr Obama said he may need another $750 billion to stabilise the financial system, though the popular perception that the $700 billion has achieved little decreases the chances of his getting it. Tim Geithner, Mr Obama's treasury secretary, reportedly abandoned plans for a "bad bank" to get distressed assets off the books of the financial system and help restart lending because of the political cost.

Mr Geithner's own efficacy has been hamstrung by the fact he remains his department's only Senate-confirmed official: 17 other top Treasury jobs requiring Senate approval remain vacant. In 2007 the Treasury website listed 120-odd officials, from Hank Paulson, the then treasury secretary, down. The current version of the same webpage lists just one: Mr Geithner. Candidates for the top jobs have been delayed or discouraged by Mr Obama's gruelling background checks, made more so by Mr Geithner's own tax problems, and the cloud over anyone who worked on Wall Street, meaning most of those with practical experience relevant to the crisis.

All this has left foreign officials and domestic bankers frustrated at the lack of consultation from the Treasury. Some foreigners say planning for the G20 meeting in London next week is being affected (see article). "They're overwhelmed," says Ken Lewis, chief executive of Bank of America. The administration disputes this but admits unprecedented demand for Treasury officials' attention.

Whatever the cause, the strain on the Treasury is encouraging the view that Mr Obama's agenda is being driven by political advisers and Congressmen, both more attuned to voters' rage than to market confidence. Chris Dodd, who faces a battle to retain his Connecticut Senate seat in 2010, inserted tough new restrictions on bankers' pay into the fiscal stimulus package despite the administration's objections. Since then, a series of mostly small banks have said they will return bail-out money, frustrating the plan to increase the banking system's capital and lending capacity.

For their part the Republicans have been able to shift the debate away from the need for government spending to dodgy examples of it. The Democrats had to fight hard to pass a $410 billion bill to finance the remainder of the current fiscal year this week, in part thanks to blistering attacks by Republicans on its 8,500 "earmarks"—pet projects inserted by legislators—though they total less than $8 billion.

William Galston, a former aide to Bill Clinton, this week advanced two "equally depressing" theories for why Mr Obama's team has not more forcefully addressed the crisis: "Either they do not know what to do, or they do not believe they can muster the political support to do what they know needs to be done." He advised Mr Obama to focus his attention on the crisis, or risk the loss of confidence Jimmy Carter suffered three decades ago. That would bring Obamabears out in droves.

Science and the president

A new era of integrity, sort of

Mar 12th 2009 | WASHINGTON, DC
From The Economist print edition

A science-friendly president overstates his case

DURING his campaign, Barack Obama promised to end two wars. The one in Iraq smoulders on. But "The Republican War on Science", to borrow the title of an influential book, is now over. On March 9th, as he lifted some restrictions on federal funding for stem-cell research, Mr Obama spoke of "restoring scientific integrity to government". From now on, he said, scientists will be "free from manipulation or coercion," and the government will "[listen] to what they tell us, even when it's inconvenient." Unlike a certain ex-president, Mr Obama will ensure "that scientific data [are] never distorted or concealed to serve a political agenda."

Democrats have long argued that Republicans are anti-science. The party of George Bush, they contend, favours teaching creationism, denies that mankind is broiling the planet and blocks medical research out of religious pigheadedness. There is some truth to these allegations, but less than the slogans allege.

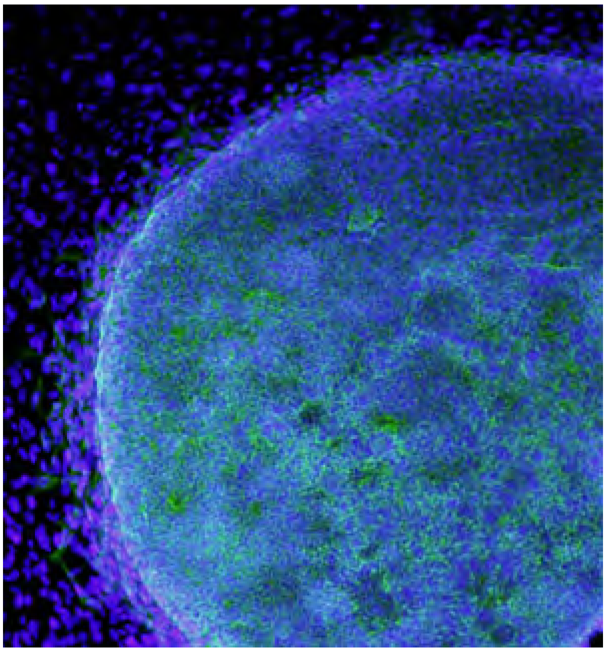
Although most Americans support the teaching of creationism alongside evolution in public schools and Mr Bush has said he agrees, in practice this almost never occurs, and is quickly stopped by the courts when it does. Republican doubts about the severity of global warming are much more serious, and have undoubtedly slowed the adoption of carbon curbs. But such doubts are fading. Few Republicans still deny that global warming is man-made. A more common objection to Mr Obama's cap-and-trade proposal is that it would amount to a huge tax hike in the middle of a recession.

The stem-cell controversy is also complex. Stem cells are cells that have yet to decide what they want to be. That is, they can grow up to become skin cells, muscle cells or nearly any other type of cell. The most versatile ones are derived from embryos. Scientists hope that experiments using embryonic stem cells will help treat diseases such as Parkinson's and cancer. But such experiments destroy human embryos, so right-to-lifers object. In 2001, Mr Bush ordered that federal funds be used only for experiments on embryonic stem-cell lines that already existed.

Several states stepped into the breach: California, for example, set aside $3 billion for embryonic stem-cell research. With federal funds soon to flow, some states may now cut back. But overall, funding for stem-cell research will surely increase, raising hopes for many sick people.

Politics and science will still clash, however. Reasonable people disagree about what kind of research is moral. Mr Obama, for example, thinks that the use of cloning for human reproduction is "profoundly wrong". Plenty of libertarians disagree. Many of Mr Obama's supporters believe that experiments on animals are immoral. Resolving such disputes is a job for elected politicians, informed by science but not dictated to by scientists.

Reuters



Good to go

Mr Obama likes to duck the thorniest disputes, for example by leaving it to the National Institutes of Health to decide what kind of embryos can be used in federally-funded experiments. Should researchers use only embryos left over at fertility clinics, which would otherwise be discarded? Or may they create embryos specifically to experiment on? Mr Obama did not say.

Other controversies loom. Many scientists doubt that "clean coal" technology is a practical way of tackling climate change. But there are coal mines in swing states, so Mr Obama loudly supports it. Drug firms say Mr Obama's efforts to squeeze drug prices will deter innovation. A recent Supreme Court ruling could do the same: it allowed a patient to claim damages from a drug firm when, despite six warnings not to inject an anti-nausea drug into an artery, a doctor's assistant did just that.

Meanwhile, Mr Obama's vow never to fiddle data rings a little hollow. Last week, for example, he declared that "[t]he crushing cost of health care causes a bankruptcy in America every 30 seconds." *The Economist* credulously repeated this claim. But it is false. The study on which it is based found that number of bankruptcies in 2001 from all medical-related causes, not just the cost of health care. That includes people who could not work because they were sick. In politics, all too often, eloquence trumps accuracy.

Barack Obama and education

The teacher-in-chief speaks

Mar 12th 2009 | WASHINGTON, DC
From The Economist print edition

But will the states listen?

GEORGE BUSH'S education secretary, the splendidly-named Margaret Spellings, used to say that since the federal government provided 8% of the funds for public schools, it should have an 8% say in how they were run. She meant to sound optimistic; but she only reminded people just how little influence Washington has.

For those who listened carefully, that was the underlying theme of Barack Obama's big schools speech on March 10th. He promised that "America's entire education system [will] once more be the envy of the world." But the plans he laid out for achieving this goal consisted largely of pleading with states and school districts—which actually run the show—to do a better job.

"Let's challenge our states to adopt world-class standards," he said, putting his finger on a huge problem. Currently, the federal government tosses bundles of cash at states where children improve their test scores. Since there is no central control of standards, states can get free money simply by making tests easier to pass.

As Mr Obama lamented, fourth-grade (ie, nine-year-old) readers in Mississippi can score 70 points worse than their peers in Wyoming and receive the same grade. The Fordham Institute, a think-tank, measured the same 18 primary schools by different states' benchmarks. In rigorous Massachusetts, only one passed muster. In sloppy Wisconsin, 17 did. Mr Obama promised that, later this year, he would tie federal money to results. But he did not say how.

He correctly identified another problem: that while most American public schools are pretty good, a significant minority are atrocious. He put it more politely, of course, noting that a mere 2,000 high schools (out of 28,000) produce more than half of all dropouts. Dysfunctional schools are concentrated in the rougher parts of cities, such as Detroit and Los Angeles. Mr Obama offered some sensible small ideas, such as extra money for pre-school, and hinted at bigger reforms.

He urged the states, for example, to stop restricting the number of charter schools. These are publicly funded but autonomous schools that, freed from bureaucracy, typically educate poor children better for less money than nearby public schools do. Naturally, the bureaucrats hate them. Many states restrict the number that can be set up. "That isn't good for our children," said Mr Obama. But he cannot force the states to stop doing it.

Mr Obama called for longer school hours, which teachers' unions are not keen on, and merit pay, which they hate. Ever tactful, he avoided the incendiary word "merit". But he said that "good teachers will be rewarded with more money for improved student achievement". As for persistently bad teachers, he pointed out that "There's no excuse for [them] to continue teaching." Parents would love that; but no president has come close to achieving it.

Meanwhile, Democrats in Congress quietly voted to kill a voucher programme that allows around 1,700 students, mostly black, poor or both, to escape Washington, DC's, awful public schools and attend private ones. Mr Obama supports killing the programme, but his flacks say he wants the students currently enrolled in it, who include two at his daughters' excellent private school, to be allowed to complete their studies. How kind.

The death penalty

Saving lives and money

Mar 12th 2009 | NEW YORK
From The Economist print edition

States plagued by fiscal woes rethink their stance on the death penalty

AN EYE for an eye, or at any rate a death for a death, is the type of justice that most states still embrace. Only 14 of the 50 states have banned capital punishment. But that may change with the recession. As state governments confront huge budget deficits, eight more states have proposed an unusual measure to cut costs: eliminate the death penalty.

The states considering abolition, including Colorado, Kansas, New Mexico and New Hampshire, have shifted the debate about capital punishment, at least in part, from morality to cost. Studies show that administering the death penalty is even more expensive than keeping someone in prison for life. The intensive jury selection, trials and appeals required in capital cases can take over a decade and run up a huge tab for the state. Death row, where prisoners facing execution are kept in separate cells under intense observation, is also immensely costly.

A recent study by the Urban Institute, a think-tank, estimates that the death penalty cost Maryland's taxpayers $186m between 1978 and 1999. According to the report, a case resulting in a death sentence cost $3m, almost $2m more than when the death penalty was not sought.

In an age of austerity, every million dollars counts. Proponents of the abolition bills describe the death penalty as an expensive programme with few benefits. There is little evidence that the death penalty deters. In fact, some of the states that most avidly execute prisoners, such as Texas and Oklahoma, have higher crime rates than states that offer only life in prison without parole. There is also the danger that innocent people may be put to death. So far, more than 130 people who had been sentenced to death have been exonerated.

Colorado, one of the states that has introduced a bill to overturn the death penalty, intends to spend the money it will save each year by eliminating capital punishment on an investigations unit. According to Paul Weissman, the state House majority leader and the bill's co-sponsor, around 1,400 murders are still unsolved in the state. Eliminating the death penalty will finance the new unit and leave an extra $1m for other state programmes. Other states are trying to free up funding to help offset their huge deficits. Savings from abolishing the death penalty in Kansas, for example, are estimated at $500,000 for every case in which the death penalty is not sought.

Many other states, including Texas, which last year carried out almost half of all executions in America, have no plans to follow suit. But a prolonged recession may change a few Texan minds.

Africa policy

Don't expect a revolution

Mar 12th 2009 | NEW YORK AND PRETORIA
From The Economist print edition

Barack Obama may differ little from George Bush in his approach to Africa

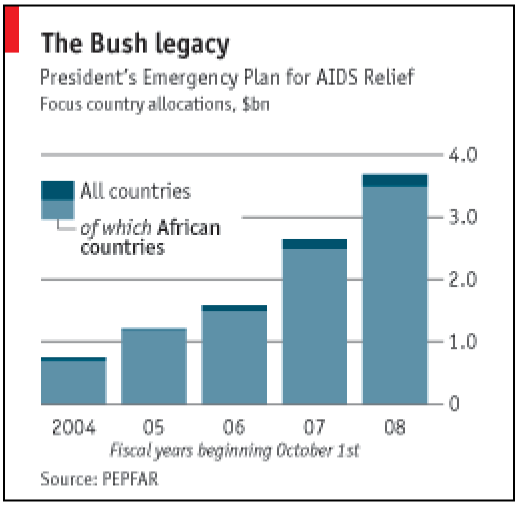
IT MIGHT seem obvious that American policy towards Africa would change under America's first African-American president. But while the new man seems set to break with his predecessor in many other foreign-policy areas, changes towards Africa may be less substantial.

Though unloved in much of the world, George Bush is still popular in most of Africa. He vastly increased America's development aid towards the continent. He created the President's Emergency Plan for AIDS Relief (PEPFAR), which was reauthorised last year with a budget of $48 billion over five years, to help stop the spread of HIV and to treat those infected. While PEPFAR has been less successful at prevention than its proponents had hoped, it has kept 2.1m people, most of them African, on life-saving antiretroviral treatment.

One much-criticised PEPFAR provision was an anti-prostitution pledge required of recipients, who had to swear that they would not "support" prostitution. This provision was retained when the plan was reauthorised last year, and Mr Obama cannot change it without rewriting the basic law. In any event, many anti-AIDS campaigners found ways of getting round Mr Bush's restrictions. So beyond sacking the boss of PEPFAR, which he has just done, Mr Obama is unlikely to do much to change a policy that is working well.

Mr Obama brings with him some big figures with strong opinions on one of Africa's bloodiest conflicts, in the Sudanese region of Darfur. Joe Biden, his vice-president, has called in the past for a threat of military action against the Sudanese government to stop the killings there. Mr Obama's ambassador to the UN, Susan Rice, has backed the threat of force too. Samantha Power, who has joined Mr Obama's National Security Council, is a historian of genocide who, though she believes in toughening sanctions and divestment from Sudan, opposes military intervention. If the conflict worsens, Mr Obama could face difficult choices.

But here too there may be more continuity than change. The International Criminal Court at The Hague recently indicted Omar al-Bashir, Sudan's president, for war crimes. Mr Bush vociferously opposed the court. But he could be pragmatic about it if it suited American policy; his ambassador to the UN abstained when the Security Council first referred Sudan to the court. So the Obama administration's position is not entirely new, though a call from a popular new black president to African leaders, asking them to shun an indicted war criminal, may be harder to ignore.



On Somalia, another of the continent's nastiest conflicts, Mr Obama is likely to be cautious. Mr Bush backed Ethiopia almost unconditionally when it invaded Somalia to overthrow an Islamist regime. Mr Obama may shift tack a bit, perhaps slightly edging away from the Ethiopian regime, but will be as wary as Mr Bush of getting involved in Somalia.

Kenya has long been one of America's key African allies. Since a disputed election at the end of 2007, it has been floundering under a shaky coalition government (see article). If violence returns, its people may expect Mr Obama, whose father was Kenyan, to wave his wand. But however strong his family ties, he is unlikely to get deeply embroiled.

Nor, given the parlous state of America's economy, is he likely to increase aid to Africa much. He is treading softly, knowing that none of the conflicts in Congo, Somalia, Sudan or Zimbabwe has an easy

solution. He may urge South Africa to squeeze Robert Mugabe out of power. But America has no particular influence over these places. Besides, Mr Obama has yet to name his assistant secretary of state—the top appointment—for Africa; other assistant secretaries, for apparently higher-priority regions, have already been tipped.

3D viewers

The final reel

Mar 12th 2009 | ST LOUIS
From The Economist print edition

Goodbye to the Grand Canyon in 3D

A PIECE of the American experience has faded away. Fisher-Price, the toy company that used to market them, has just eliminated almost all the View-Master titles that have been a staple of young lives for almost 70 years.

The boxy binocular-style viewers remain; but the circular reels that brought three-dimensional images of the world to millions have now been cut back to a handful of children's titles. Long before the internet, or even before most people had colour televisions, View-Masters gave millions a full-colour, three-dimensional view of the world.

View-Masters were introduced at the 1939 New York World's Fair and became an overnight sensation. During the second world war the armed forces produced training reels for identifying enemy and friendly aircraft and ships. After the war View-Masters became household items, as common as frozen food. Thousands of businesses promoted themselves using custom-made View-Master reels. Recently the University of Missouri football programme promoted its candidate for the Heisman trophy by giving away viewers moulded in the college colours and a reel of highlights from the season. Medical students used View-Master to study a 3D atlas of human anatomy. In all, more than 1.5 billion reels have been produced, every one of them to the same size and format, and usable in every model of viewer ever made.

The gutting of the View-Master comes just as 3D is experiencing a renaissance. Improved technology has made 3D films much easier to produce and view, allowing them to progress far beyond the gimmicky thrusting of objects into the audience seen in films briefly in vogue in the 1950s. The Jonas Brothers, the latest boy band for teenage girls, recently released a concert film in 3D and also appeared on a 3D magazine cover. Several commercials aired during the Super Bowl, the climax of the football season, were broadcast in 3D. George Lucas is said to be toying with the idea of re-releasing the "Star Wars" saga in a retrofitted 3D format; recent blockbusters, including "Kung Fu Panda" and "Beowulf" have appeared in 3D versions at special cinemas, with many more to come. But the experience of 3D in your hand, which the View-Master made possible, is now a thing of the past.

Pennsylvania's burning mines

Fire in the hole

Mar 12th 2009 | WILKES-BARRE, PENNSYLVANIA
From The Economist print edition

What to do about smouldering acres underground

THE legend blames a lantern forgotten by a miner at the end of his Friday shift. When he and his colleagues returned to the Red Ash colliery on Monday, they found the mine burning. That was way back in 1915. But the fire still burns.

Smoke rises from vents and gaping holes in a scrubby hillside above Wilkes-Barre. The ground remains warm to the touch and the hilltop view looks over a blighted landscape: scrawny trees, ash and the telltale broad scars of strip-mining (deep-coal mining, the type with miners and lanterns, is long gone).

Red Ash is the oldest of 36 fires currently blazing in Pennsylvania's 180,000 acres (73,000 hectares) of abandoned mines. The most famous is beneath Centralia, which began in 1962 when residents burned some rubbish on top of an exposed coal seam. In 1981 a hole there swallowed an 12-year-old boy; Pennsylvania has since condemned the entire town, relocated almost all its residents and had its postal code revoked. Like Red Ash, Centralia's fire is thought to have enough fuel to burn for many more decades.

Around 850 residents near the Red Ash mines were also moved out, though today a trailer park sits just a few hundred yards from numerous vents and smoking crevasses. Evacuating people has proved cheaper than trying to put the fires out. The intricate subterranean network of tunnels and anthracite veins makes extinguishing them both expensive and uncertain to succeed—politically, a losing combination.

But GAI Consultants, a Pittsburgh-based engineering firm, has a solution, successfully employed at the Percy colliery in western Pennsylvania. From a mixture of ash, lime and sludge left over from coal-fired power plants, they created a concrete-like substance, 119,000 cubic yards (91,000 cubic metres) of which they pumped into the mine. This both contained the fire and starved it of oxygen.

Unfortunately, the concrete-like substance travels poorly: it begins to harden soon after being mixed, limiting its use to those mines which happen to be near coal-fired power plants—and like mines themselves, these are a disappearing species in Pennsylvania. Besides, Percy was a relatively small fire; Centralia currently covers 600 acres, and could expand to 5,000, making even token efforts to extinguish it prohibitively expensive.

"When we were pulling [coal] out of the earth," says Tom Rathbun, of Pennsylvania's Department of Environmental Protection, "it was America's natural resource. Now that it's over, it's Pennsylvania's problem." The Red Ash fire looks set to supply the fireworks for its own centenary.

The border

Hoping for a silver lining

Mar 12th 2009 | MCALLEN, TEXAS
From The Economist print edition

The poorest part of Texas prepares for the bad times

AT HIS old job, Christian Garcia made root beer at a restaurant for $9 an hour. He thought the pay was too low; in any other city he would have expected $13. But he lives in McAllen, a border city in Texas with no shortage of workers. He reckoned that if he objected, he would have zero dollars an hour. Anyway, he was soon able to find another job, at a stylish new seafood restaurant downtown. All things considered, he was confident about the local economy.

Many Americans wish they felt so serene. But Mr Garcia's attitude is not uncommon in Hidalgo County, which encompasses McAllen, Mission, Edinburg, Pharr, and a handful of other towns in Texas's Rio Grande Valley.

The Valley has historically been, and remains, one of the poorest parts of the country. And, like most places, it is feeling the pinch. In January, according to the Texas Workforce Commission, unemployment in the McAllen metropolitan area (which includes all of Hidalgo County) hit 10.1%. That is well above the Texas average of 6.8%, and almost three points higher than the year before.

But unlike many pinched places, McAllen has cause for a degree of optimism. In 2008, according to RealtyTrac, a property analyst, the McAllen-Edinburg-Pharr market had one of the lowest foreclosure rates in the country. A January study commissioned by the United States Conference of Mayors predicts that McAllen-Edinburg-Mission will be one of only three metropolitan areas to add jobs this year—out of 363. (The area promptly lost hundreds of jobs that month, however.)

And locals have a different perspective on the recession from their counterparts in wealthier parts of the country. McAllen's situation was worse not so long ago. Keith Patridge, the president of the McAllen Economic Development Corporation, moved to Hidalgo County in 1982. At the time McAllen's main industries were retail, tourism and farming, and each was in trouble. The devaluation of the Mexican peso in the 1980s put a damper on cross-border shopping; local tourism was down because of the recession. In 1983 a freeze took out much of the Valley's citrus crop.

In the mid-1980s, fuelled by trade and the growth of the *maquiladora* programme (in which components are shipped to Mexico, assembled and shipped back), things began to pick up in Hidalgo County. McAllen sits across the border from Reynosa, a large manufacturing centre. After the peso devalued it became easier to woo companies to put their plants in Mexico with support operations in Texas. Workers came for jobs. Winter Texans returned to enjoy the sun and practise their square-dancing. And Mexicans came to spend money. Thanks to tourist dollars, McAllen has the highest retail spending per capita in the state, says its Chamber of Commerce. The result was unprecedented growth, and Hidalgo County's population soared from about 280,000 people in 1980 to over 700,000 in 2007.

In the past few months that growth has been checked. Shrivelling access to capital threatens further development, and manufacturers have been hit hard over the past year. The retail sector is also suffering because the peso has once again dropped against the dollar, though McAllen is still a shopping hub. There are more serious problems, such as Mexico's crumbling security situation. Gang violence has Reynosa in high alarm, though it has yet to spill across the border. And parts of Hidalgo County remain desperately poor. Thousands of people still live on the outskirts of town in *colonias*, unincorporated neighbourhoods without basic services.

But, all things considered, Hidalgo County is optimistic. Cynthia Brown of the University of Texas-Pan American, in Edinburg, predicts that McAllen is primed to resume its growth once the economy improves. Its population is young, and its position on the border makes it a strategic spot for several industries. The city is even working to develop a central entertainment district, in hopes that McAllen will someday compare to Austin as a destination for young professionals. That is a stretch. But McAllen should weather the recession well enough.

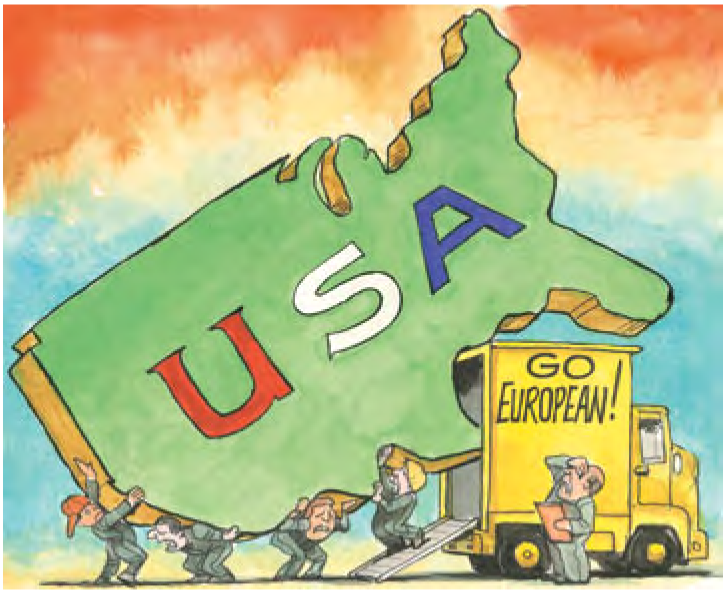
Lexington

Le vieux canard

Mar 12th 2009
From The Economist print edition

More nonsense about Europe and America

Illustration by KAL



A SPECTRE is haunting the United States—the spectre of Europe. Republicans such as Newt Gingrich, the grand old man of the party, and Mike Pence, one of its firebrands, say that Barack Obama's Democrats are imposing "European-style socialism" on America. "As they try to pull us in the direction of government-dominated Europe," says Mitt Romney, arguably the front-runner for the Republican nomination in 2012, "we're going to have to fight as never before to make sure that America stays America."

This sort of sentiment is not confined to the cave-dwellers of the right. Roger Cohen, a liberal *New York Times* columnist, worries that "one France is enough". Kenneth Rogoff, a Harvard economist, says "I take the 2008 US elections as marking a turn toward continental Europe." Six years after Robert Kagan claimed that "Americans are from Mars and Europeans are from Venus", there is a growing feeling that the two planets are destined to merge.

But are they? They are certainly getting a bit closer. Mr Obama is raising taxes on the rich, bailing out failed businesses, tackling climate change and dramatically increasing public spending. A decade ago American government spending stood at 34.3% of GDP compared with 48.2% in the euro zone, a gap of 14 points; in 2010 it is expected to be 39.9% of GDP compared with 47.1%, a gap of less than eight points, according to *Newsweek*.

What is more, Mr Obama's rise has coincided with a softening of American exceptionalism. America is unlikely to repeat George Bush's America *über alles* foreign policy in the near future. A growing number of states have imposed moratoriums on the death penalty. Support is growing for everything leftish, from tackling global warming to letting gays marry.

Still, the two planets have a very long way to travel before they meet. Consider a horrific event at a First Baptist Church in Illinois on March 8th. An unknown assailant pulled out a semi-automatic weapon and started firing at the preacher. The preacher managed to deflect the gunman's first four rounds using his Bible, sending a confetti-like spray of paper into the air, but was eventually felled. That is not the sort of thing that goes on of a Sunday in Tunbridge Wells.

There is nothing particularly "European" or "socialist" about Mr Obama's stimulus package. Countries the world over are spending public money in a bid to boost demand and shore up the banks. Indeed, some of the most stubborn resistance to deficit financing has come from Europe, particularly from Germany and the EU finance ministers. Messrs Gingrich and Romney might note that the man who set this ball rolling was not Mr Obama but Mr Bush, the most un-European politician imaginable.

What about Mr Obama's plans to raise taxes and redirect social policy? There are plenty of plausible criticisms of these (such as the fact that his numbers do not add up), but the idea that they entail "full-scale Europeanisation", as Mark Steyn, a columnist, argues, is one of the least persuasive. Mr Obama's budget will return the top tax rates to 36% and 39.6%—back to where they were during Bill Clinton's administration. Mr Clinton ended up presiding over the high-tech boom and a surge in the number of small businesses. Mr Obama has eschewed the single-payer model of health-care reform long advocated by the European-minded left; he wants to use public insurance to supplement the private system, not supplant it. Many of the strongest supporters of his health-care reforms are business people who are being crushed by the exorbitant cost of health care.

For all Europe's Obamamania Mr Obama is, in fact, one of the least European-minded of American presidents. JFK studied at the London School of Economics with Harold Laski, a leading British socialist. Bill Clinton went to Oxford University and surrounded himself with Rhodes scholars who liked to discuss the German educational model. John Kerry was famously not just French-speaking but also "French-looking".

Mr Obama's roots lie in Kenya, Indonesia and Kansas—any continent but Europe. His two books hardly mention Europe at all. "The Audacity of Hope" includes a reference to the idea that America should "round up the United Kingdom and Togo" as supporters—and then do as it pleases. The only European country that gets a mention in the index under "Foreign policy, US" is Ukraine—and that nation gets less space than Indonesia.

Consider the converse

The fury about "European socialism" is not just wrong as a matter of fact. It is foolish as a matter of policy. Europe has plenty of things to teach the United States (particularly about running a welfare state), just as America has plenty to teach Europe (particularly about igniting entrepreneurialism). Indeed, a more telling criticism of the Obama administration is not that it is borrowing too much from Europe but that it is learning too little.

Sweden and the Netherlands have a comprehensive system of school choice (the Dutch even allow public money to flow to religious schools). Switzerland and the Netherlands have a market-based system of health care which uses private insurers, covers everyone, and does so at a much lower cost than the American system. Britain has taken contracting-out in the public sector much further than America has done.

Europeans and Americans are never likely to coalesce: their cultural traditions are too strong and their solutions to the problem of regulating capitalism too distinctive. But they nevertheless have plenty in common—ageing populations, exploding entitlements and above all, at the moment, a wrenching recession. Europeans have thankfully toned down the America-bashing that was popular a few years ago. Americans might consider returning the compliment.

Lexington now writes a blog, which is open for comment at Economist.com/blogs/lexington

El Salvador's presidential election

A nation divided

Mar 12th 2009 | SAN SALVADOR
From The Economist print edition

Will a country still haunted by the cold war dare at last to embrace the left?

AP

DURING the 1970s and 1980s El Salvador briefly became an ugly little sideshow in the cold war, as an American-backed army battled Cuban-supplied left-wing guerrillas of the Farabundo Martí National Liberation Front (FMLN). Although peace and full democracy arrived in 1992, the war has haunted politics ever since. With the fighting over, the FMLN became a political party. But by fielding former guerrilla commanders as its presidential candidates it scared away moderate voters. So the conservative Arena party has governed without interruption.

Is this pattern about to change in the presidential election on March 15th? The FMLN has high hopes. There has been a move to the left, of different kinds, in the other countries of Central America. Arena's stewardship of the economy has been less than stellar: growth in El Salvador has been below the Latin American average in recent years. And this time the FMLN has found a seemingly attractive candidate in Mauricio Funes, a television journalist who joined the party only in 2008 and presents himself as a fresh, moderate politician in the mould of Barack Obama or Brazil's Luiz Inácio Lula da Silva. In legislative elections in January the FMLN won 42.6% of the vote, displacing Arena (38.5%) as the largest party in Congress.

An FMLN victory would show that power can alternate and consolidate democracy. But it would raise other doubts, and is anyway far from assured. Mr Funes has seen a double-digit lead in opinion polls narrow to a dead heat with Arena. In January's election, the FMLN lost the mayoralty of San Salvador, the capital and long a left-wing bastion. The electorate, in a country with an authoritarian tradition and close economic and cultural ties to the United States, has a conservative instinct. Crime, especially the violence of youth gangs, is a big issue. In 2008 El Salvador had the world's highest murder rate. Arena's hardline approach to this has achieved little, but hard lines are popular. And Arena's presidential candidate, Rodrigo Ávila, is a former police chief.

Arena also has the advantage of incumbency, the support of most media and a lot more money to splash

around. It has placed almost four times as much advertising as the FMLN, according to a study by Funde, a think-tank in San Salvador. Many analysts consider it to be the best-organised political party in Latin America. It is also much more pragmatic than the left. Arena has persuaded candidates for two other parties, one conservative and the other centrist, to withdraw.

For its part, the FMLN seems to have damaged its chances by naming Salvador Sánchez Cerén as its candidate for vice-president. During the war Mr Sánchez led an uncompromisingly Marxist faction of the guerrilla army. He crystallises the fears of some Salvadoreans that Mr Funes is a front man for a party still controlled by the far left, which would align El Salvador with Cuba and Hugo Chávez's Venezuela. Whereas Mr Funes has shunned any dealings with Mr Chávez, many FMLN mayors receive subsidised oil from Venezuela. The name of one of its congressmen surfaced in a computer recovered at the camp of Raúl Reyes, a leader of Colombia's left-wing FARC guerrillas killed a year ago. Tensions between Mr Funes and party officials have occasionally flared up during the campaign. "Funes is a democrat, but much of his party is not," says Roberto Rubio of Funde. "A lot of them see democracy as a means to make the revolution."

Some of these fears may be overdone—and certainly Arena has done its best to stoke them. An FMLN government would have to contend with a legislature in which Arena could command a majority through alliances. And whoever wins will have to govern in hard times. The economy, which depends heavily on Salvadorean workers in the United States (some 2.5m of 8m Salvadoreans live abroad), is grinding to a halt as their remittances shrink. The government has had to delay payments of energy subsidies and to suppliers. It has turned to the IMF and to multilateral development banks for support. Economic stagnation may aggravate crime.

The close electoral battle poses another risk. The FMLN routinely alleges electoral fraud, accusing the electoral tribunal, which has a conservative majority, of bias. Foreign election observers disagree—and will again be on hand. Even so, a narrow win by Mr Ávila may prompt the FMLN to cry foul and take its protests to the street. Its tightest election may put this young democracy to a stern test.

Socialism in Venezuela

Feeding frenzy

Mar 12th 2009 | CARACAS
From The Economist print edition

Statism on the march

AP

Revolution but no rice

HARD on the heels of winning a referendum to abolish term limits last month, Hugo Chávez, Venezuela's president, is trying to fend off economic worries by taking on the private sector, especially companies in the politically sensitive food and farming industries.

First to feel the impact were rice processors. A rice plant belonging to Cargill, an American company, was seized for allegedly violating the "food security" law. Two plants owned by Empresas Polar, Venezuela's largest private conglomerate, were taken over "temporarily" to enforce production of price-controlled rice. Like other companies, Polar argues that controls force it to sell at a loss. It has been selling flavoured varieties of rice, hitherto unregulated. Mr Chávez rejects this argument, and threatened to expropriate all Polar's businesses (which include brewing) and to pay compensation in bonds rather than cash.

Rice is a staple for Venezuelans, but it has recently been scarce. The government claims there is no shortage. But rice producers say output has fallen because there is no incentive to invest in either factories or farms. They point out that the government itself supplies around half the market, and complain that its imports are undermining their businesses.

The government has also taken over two other factories, one making pasta and the other a tuna-canner. Other factories producing staple foods are being inspected, and ordered to concentrate on making price-controlled goods. Owners fear that will force them into bankruptcy. Several farms have been taken over by troops and civilian supporters of the government. Elías Jaua, the agriculture minister, says the government seeks "hegemony" in food and farming. "Against the logic of capitalism", declared Mr Chávez, "let us construct a new logic, that of socialism."

The government's finances have been weakened by the collapse in the price of oil, which last year provided over 90% of Venezuela's export earnings. It is haunted by the events of 20 years ago, after oil prices had again fallen, in which food shortages and bungled austerity measures prompted riots and looting, and hundreds of people were killed by troops. Mr Chávez claims these events as the starting-point of his "revolution".

This time will be different, he says, with the army siding with the poor against the rich, and economic tension providing an opportunity to move forward with socialism. But he is being as tough on trade unions as on business. Workers on the Caracas metro, protesting about the government's refusal to respect collective agreements, were threatened with a military takeover. He denounced workers at Sidor, a recently nationalised iron and steel plant, as "corrupt" and "saboteurs" for protesting over wages and conditions.

Some of the president's own supporters disagree with these confrontational policies. José Vicente Rangel, who served for several years as Mr Chávez's vice-president and is still close to him, said on his weekly television programme that none of the problems facing the country would be resolved without dialogue. "There'll be no pact with the oligarchy," was the president's public response.

Bolivia

The justice of crowds

Mar 12th 2009 | LA PAZ
From The Economist print edition

An outbreak of government paranoia

IN THE mid-1990s, when he was vice-president, Víctor Hugo Cárdenas, an Aymara Indian, oversaw the introduction of bilingual education: pupils were to be taught in their indigenous language as well as Spanish. You might think that would still endear him to Bolivia's Indians. Not so, to some of them at least.

Having disappeared from the political limelight for a decade, Mr Cárdenas recently emerged as a powerful opponent of the new constitution promoted by Evo Morales, a fellow Aymaran who, as president since 2006, claims to be refounding the country along indigenous-socialist lines. Ahead of a referendum in January in which voters approved this document, Mr Cárdenas appeared in opposition television advertisements. He says that the constitution's endorsement of "community justice" is a "mechanism of abuse".

On March 7th a mob of indigenous people several hundred-strong attacked Mr Cárdenas's house in a village on the shore of Lake Titicaca, violently evicting his wife, Lidia Katari, herself an indigenous-rights activist, and two of his children before setting fire to his belongings. The few police who turned up did nothing. The assailants claimed that they had staged an act of "community justice" against Mr Cárdenas. They later said that they would not allow him, the police or public prosecutors to enter the area, claiming that the new constitution gives them control over a large swathe of surrounding territory.

Mr Morales may well have had nothing to do with the attack. But his opponents have long claimed that he is opening the way to this kind of mob rule. The government information service implausibly claimed that Mr Cárdenas had staged the incident himself as a publicity ploy.

Certainly, Mr Cárdenas has emerged as a potential leader for an opposition hitherto dominated by lighter-skinned Bolivians from the eastern lowlands. Under the new constitution, a presidential election is due to be held in December in which Mr Morales will seek a second term. And he suddenly looks rattled.

In an opinion poll in January by Ipsos-Apoyo, a respected pollster, the president's popularity rating had slipped to 53%, nine points down from November and the lowest level for two years. Since then the government has been shaken by a corruption scandal at YPFB, the state-owned oil and gas company which Mr Morales revived. Santos Ramírez, the company's president, was sacked and arrested, accused of orchestrating backhanders of over $3m from a company contract. Other YPFB officials are implicated.

What makes this so damaging is that Mr Ramírez was a senior leader in Mr Morales's Movement to Socialism. And the nationalisation of the natural-gas industry, along with the new constitution, is the president's main initiative. The opposition claims that the policy of giving state companies free rein to sign contracts—which the government says is necessary to sidestep bureaucracy—is a recipe for graft.

In another sign of growing official paranoia, Mr Morales blamed the YPFB imbroglio on the CIA, expelling an American diplomat this week who he claimed was involved (he turfed out the ambassador last year). He still has a bedrock of support among poorer Bolivians of Indian descent in the west of the country. But he is starting to look as if he is on the defensive.

History in Peru

Don't look back

Mar 12th 2009 | LIMA
From The Economist print edition

Arguing over a museum of memory

IT HAS been much changed and improved by years of rapid economic growth and peace. But less than a generation ago Peru suffered an appalling bloodletting. A murderous guerrilla insurgency unleashed by the Maoist Shining Path and a small Marxist rival was met by indiscriminate repression by the armed forces. In 2003 a Truth and Reconciliation Commission set up by a democratic government and composed of academics and human-rights activists concluded, after an exhaustive investigation, that more than 69,000 people died in the violence between 1980 and 2000. Three out of four of the victims lived in the Andean highlands and were of Indian descent.

The commission tried hard to be even-handed. It reckoned that the Shining Path was responsible for slightly over half the killings, and the security forces for 37%. Out of its work came a harrowing exhibition of photographs and accounts by survivors. Called *Yuyanapaq* ("to remember" in Quechua), this toured Peru before finding a temporary home in the National Museum. Supporters of the commission want to set up a permanent "museum of memory". Last month the German government offered to build the museum at a cost of $2m.

But Peru's government has rejected the money, and says it doesn't want the museum. Ántero Flores-Aráoz, the defence minister, said that it was "not a priority" in a country where "there are other basic needs to satisfy", such as food, health and schools. (He also noted that the Shining Path survives and killed a soldier this month, though it numbers only a few score in remote parts of the Amazon jungle.) "Memory doesn't belong to a particular group," added Alan García, the president.

The rejection has been criticised across much of the political spectrum. In a withering article Mario Vargas Llosa, a Peruvian novelist who is also Latin America's best-known liberal thinker, wrote that "we need a museum of memory to fight the intolerant, blind and obtuse attitudes which unleash political violence"—attitudes exemplified, he said, by Mr Flores-Aráoz's comments.

The plan for the museum coincides with a wider re-examination of Peru's violent years. They are the subject of several recent novels. *La Teta Asustada* ("The Milk of Sorrow"), a film about the trauma of a woman raped during the war, directed by Claudia Llosa, a relative of the novelist, won the top prize at last month's Berlin Film Festival. A court in Lima will shortly reach a verdict in the trial of Alberto Fujimori, an elected autocrat who, as president from 1990 to 2000, crushed the Shining Path but is accused of having authorised killings by an army death-squad.

Some Peruvians are uneasy about reopening the past. If they appear to include Mr García, that may be because worse abuses occurred during his first presidency (1985-90). His vice-president, Luis Giampietri, a retired admiral, took part as a junior officer in the suppression of a violent Shining Path prison rebellion in 1986 in which scores of inmates were killed after they had surrendered. Mr García is surely right when he says that the museum should "take all perspectives into account". But that is all the more reason for building it.

Television in Brazil

Soaps, sex and sociology

Mar 12th 2009 | SÃO PAULO
From The Economist print edition

Do women who watch telenovelas have fewer babies (but more men)?

Illustration by Claudio Munoz

THE glamorised world portrayed on the nightly *telenovelas* (soap operas) on Brazilian television is, superficially at least, about as representative of the country as a whole as Marie Antoinette and her shepherdesses were of 1780s' France. But they are all about aspiration. About 40m people watch the mid-evening *novela* from Globo, the leading network. The action often takes place in Rio de Janeiro, where Globo is based, among families which are smaller, whiter and richer than average. New research suggests that by selling this version of the country to itself, Globo has boosted two important social trends.

The soaps blossomed under Brazil's military regime of 1964-85. The generals subsidised sales of television sets to build a sense of nationhood in a large and then largely illiterate country. National news was meant to do the job, but the soaps got the audience. Their scriptwriters and directors, many of whom were on the left, saw them as a tool with which to reach the masses. Their plots often tilt in a progressive direction: AIDS is discussed, condoms are promoted and social mobility exemplified.

How much impact do the soaps have on real life? As recounted in papers from the Inter-American Development Bank, researchers tracked Globo's expansion across the country and compared this to data on fertility and divorce.*

The results are most striking for the total fertility rate, which dropped from 6.3 children per woman in 1960 to 2.3 in 2000, despite contraception being officially discouraged for some of that time. This was because women moved to cities and opted to have fewer babies. The papers argue that the small, happy families portrayed on television contributed to this trend. Controlling for other factors, the arrival of Globo was associated with a decline of 0.6 percentage points in the probability of a woman giving birth in a given year. That is equivalent to the drop in the birth rate associated with a woman having two extra years of schooling

The effect on divorce was smaller, but noticeable. The researchers found that between 1975, when divorce was first mooted, and 1984 about one in five of the main characters in Globo soaps were divorced or separated, a higher percentage than in the real Brazil. These break-ups were not just a result of machismo: from the mid-1960s to the mid-1980s about 30% of female lead characters in *novelas* were unfaithful to their partners. The researchers find that the arrival of Globo in an area was associated with a rise of 0.1-0.2 percentage points in the share of women aged 15-49 who were divorced or separated. The authors reckon that watching "empowered" women having fun in Rio made other women (a few of them anyway) more independent.

Other research shows that divorce and lower fertility are linked to less domestic violence. So the influence of soaps may be far more positive than critics of their vapidity claim. If Globo could now come up with a seductive *novela* about tax reform its transformation of Brazil would be complete.

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* "Television and Divorce: Evidence from Brazilian Novelas," by Alberto Chong and Eliana La Ferrara (January 2009) and "Soap Operas and Fertility: Evidence from Brazil," by Eliana La Ferrara, Alberto Chong and Suzanne Duryea (October 2008).

India's election

On the trail with a megastar

Mar 12th 2009 | RAJAHMUNDRY
From The Economist print edition

The political debut of Andhra Pradesh's favourite film star makes it even harder to predict what sort of government Indians are about to elect

AP

WHEN Chiranjeevi lifts his arms, a human ocean, stretching into the distant gloom, roars. Beneath the rickety stage that bears the 53-year-old film-star, idol of Andhra Pradesh's Telugu-language film industry, or "Tollywood", the crowd boils and threatens to burst. Having sweltered for hours waiting for this actor-prophet, the men and boys of Rajahmundry, a concrete city in southern Andhra Pradesh (AP), want entertainment. Feverishly, they shriek his nickname: "Megastar!"

For over an hour, Chiranjeevi, or "the immortal one", as the actor has been known for three decades, addressed the multitude on March 10th. Except for one dreadful hush, the clamour of an estimated 400,000 was unceasing. When he attacked the corruption of AP's ruling Congress party, it rose. When he accused the state's main opposition Telugu Desam Party (TDP) of neglecting the poor during its previous rule, it soared. When Chiranjeevi promised to scatter both parties in AP's state election and India's general one, which will be held simultaneously next month, the din was tremendous.

A veteran of 148 Telugu and Hindi films, Chiranjeevi launched his Prajarajyam (or "People's Rule") Party last August, on the birthday of one of his heroes, Mother Teresa. Over 1.5m are said to have attended that rally. Vowing to bring "social justice" to AP's 76m inhabitants, Chiranjeevi is in a thick tradition of actor-politicians in southern India. The TDP was founded by one. Tamil Nadu's two main parties are led by a former film star and a screenwriter. To what extent Chiranjeevi can emulate their successes is unclear. But he is likely to have a big impact on the election results of a state that, more than any other, determined the make-up of India's current coalition government, led by the Congress party, and its predecessor, led by the Hindu-nationalist Bharatiya Janata Party (BJP).

At India's last election, in 2004, Congress won 29 of its 145 seats in AP—more than in any other state. A coterminous state election, in which Congress trounced the TDP, also had wider significance. The TDP's leader, Chandrababu Naidu, had pushed business in the state. His defeat accordingly contributed to a distorted, because grossly simplistic, interpretation of the vote nationwide, as a revolt by the rural poor against a government that favoured the urban elite. In 1999 the TDP and its then ally, the BJP, had together won 36 of AP's 42 seats.

Even before Chiranjeevi's entrance, this year's election looked sure to be more open. The current state

government seems less unpopular than its predecessor was, partly because it has managed the state finances less prudently. With fat revenues from the computer-services industry in Hyderabad, the state capital, and sales of state-owned land, it has poured money into irrigation and other development. But Congress's allies, who played a big part in its 2004 victory, have deserted it. In January the biggest of these, the Telengana Rashtra Samiti (TRS) party, which wants to divide AP to make a new state of its Telengana region, joined forces with the TDP.

This followed Mr Naidu's sudden espousal of the Telengana cause, which he had long opposed. Forsaking his famed reformism, Mr Naidu is also matching the open-handed populism of his rival. The TDP has promised a massive and seemingly unaffordable cash transfer to families either side of the poverty-line, and a colour television to every family below it. Asked about this proposal, Mr Naidu concedes an embarrassed laugh.

Second-guessing Indian voters is a mug's game. But it is thought that Congress may keep power in AP, despite losing some seats in the state legislature. It is also predicted to win over 20 of AP's parliamentary seats. But it is worried that, having failed to make any progress on dividing AP, it may struggle in Telengana's 17 constituencies, and, elsewhere, be relatively hard hit by Chiranjeevi, whose support is strongest outside it. The actor claims, perhaps improbably, that he will not enter into any coalition with his rivals or with the Hindu-chauvinist BJP after the election.

Just by dividing the vote, however, he will make it harder for Congress, the BJP or India's other would-be coalition-convener, a "third front" of regional parties such as the TDP, to muster a majority in Delhi. At home in Hyderabad before helicoptering off for Rajahmundry, the affable megastar mulls the chances of a "fourth front".

That is one of the few outcomes of the general election, which will be held in five phases, between April 16th and May 13th, that can be ruled out. Neither Congress nor the BJP will come close to a majority—in 2004, they barely mustered the necessary 270-odd seats between them. Sensing weakness, many of their sometime allies, including in the "third front", are therefore loth to commit to either party until after the election. This is especially true for Congress which, as the party with the biggest national presence, fights regional battles with many of its potential allies at the centre. It is meanwhile struggling to tie up with the Samajwadi Party (SP), one of two caste-based parties that dominate Uttar Pradesh, India's biggest state, commanding 80 parliamentary seats.

Yet, amid the general uncertainty, it is the Hindu nationalists who look most worried. Under L.K. Advani, named as its prime-ministerial candidate a year ago, the BJP has failed to re-enlist several former allies, such as the TDP—and has lost others. On March 8th the Orissa-based Biju Janata Dal, which is usually good for a dozen parliamentary seats, ended an 11-year alliance. Some of its members are said to be unhappy with the BJP's Hindu-supremacist sponsors, after a year-long conflict in Orissa between Christians and Hindus, blamed on radical Hindu proselytisers.

Even if Congress fails to come to terms with the SP, it or its allies will be serious contenders in about 450 of India's 545 parliamentary seats (which include two reserved for Anglo-Indians). The BJP and its allies appear to have a fighting chance in about 340. Sadly, whoever leads India's next coalition government, it is likely to be as fractious and venal as the current one; perhaps more so. This is depressing. Yet that feeling should be tempered with wonderment that India's chaotic democracy is as resilient as it is.

Midway through Chiranjeevi's speech in Rajahmundry, disaster struck. A 30-foot-high metal pylon, overloaded with floodlights and spectators, toppled over into the throng. As it fell, with a muffled thump, the multitude went dumb. The megastar, in unfeigned horror, flung his hands to his face and staggered back. It looked as if dozens must be dead. Yet the damage was light—a few broken bones; none killed. The people below the pylon conspired to check its fall. This could scarcely have been thought possible; but it worked.

Kidnapping Hmong women in Vietnam

Bartered brides

Mar 12th 2009 | SAPA
From The Economist print edition

A cruel trade across Vietnam's border with China

FOREIGNERS have long been attracted to Sapa and its surrounding mountains in the far north of Vietnam. First it was the French colonists, who built a hill station there. More recently it has been tourists, who come to enjoy the stunning landscape of terraced rice paddies and the colourful world of the Hmong tribes, with their distinctive red, black or "flower" dress. But now, it seems, another type of visitor is finding this territory attractive: gangs of kidnappers who snatch young Hmong women for sale as brides across the border in China.

The kidnapping has been going on for some time, and locals talk of a number of cases so far this year. The abductions follow a pattern: a Hmong girl is wooed by an out-of-towner—whether from Vietnam or China is not clear—who speaks her language. She is lured to a rendezvous to be drugged and smuggled into China, probably near Lao Cai, about an hour's drive from Sapa. Tall, pretty girls are said to be particular targets.

One 18-year-old recently managed to get back home to tell her tale after a four-day ordeal. Held captive in China, she escaped through a window and contacted the Chinese police, who returned her to Vietnam. Most do not escape. One of those kidnapped last month was a married woman with a son; friends fear her family may never see her again.

There is some tradition of bride-kidnapping among the Hmong themselves, but this gangsterised, cross-border variety is especially cruel. Village girls with little knowledge of the outside world tend to be trusting. And the kidnappers seem to operate with impunity—even, according to one account, seeking a reward for returning two underage girls whom they had failed to sell in China.

Within China itself, the abduction and sale of women has long been recognised as a prevalent social evil. Three decades of strict family-planning policies have exacerbated a traditional preference for boy children and contributed to a shortage of marriageable women.

Relations between Vietnam and China along their 1,300km (800-mile) border have improved: last month officials from the two countries, which fought a brief but bloody border war in 1979, completed a seven-year effort to demarcate the frontier. This, they hope, will open the way for increased links of various sorts. Stepped-up police co-operation to stamp out an evil little trade in Hmong women would be a good start.

Indonesia's parliamentary election

Unencumbered incumbent

Mar 12th 2009 | JAKARTA
From The Economist print edition

The president in the driving seat

Reuters

On the way to re-election?

APRIL will see elections in the world's third most populous democracy as well as in its biggest. After months of largely insipid jockeying in the press, March 16th marks the start of open campaigning for voting on April 9th for Indonesia's national, provincial and district legislatures. A presidential poll follows on July 8th and, if no one secures a majority, a run-off for the two leading candidates in September.

The presidency, where most power lies, is the big prize. But in order to run, candidates must be backed by a party, or parties, that have won 20% of the 560 parliamentary seats or 25% of the popular vote in the April election. With 38 parties competing and one-fifth of the 171m voters undecided, the permutations seem mind-boggling.

The reality is clearer. Barring a cataclysm, Susilo Bambang Yudhoyono, the president, is so far ahead that his re-election should be relatively straightforward, perhaps even without a run-off. Meanwhile his Democratic Party looks poised to leap from fifth in the 2004 election to first, winning a quarter of the seats.

The Democrats' prospects owe more to Mr Yudhoyono than the party's own performance. Indeed, with the politics of personality eclipsing policy debate, Mr Yudhoyono's record should prove decisive in every campaign. Poverty and unemployment levels have dropped, although not as much as promised. The public seems satisfied that the war on the nation's endemic corruption is going well enough. The multibillion dollar reconstruction after the 2004 Indian Ocean tsunami has been a success. Devolution of power has left many regions better off. And a 29-year separatist conflict in Aceh is over—indeed, as part of the peace deal, six local parties will for the first time contest the sub-national elections. The Aceh Party, representing the former separatists, is expected to do best, though not as well as it says it will.

Recently the fall in oil prices has enabled Mr Yudhoyono to cut subsidised fuel prices three times. He has also given civil servants a pay rise of more than a third. Last year Indonesia achieved rice self-sufficiency for the first time in decades, which means that retail prices this year have not suffered their usual first-quarter spike. And, crucially, Indonesia is weathering the global financial economic slump better than most places. No less crucially, Mr Yudhoyono has persuaded enough people not to blame him for the downturn.

He also benefits from the absence of any credible challenger. His nearest, and very distant, rival is his underwhelming predecessor, Megawati Sukarnoputri, daughter of Indonesia's first president. Everyone else is nowhere, including the leaders of Golkar, once the political machine of the ex-dictator Suharto and still the largest party in parliament. Many analysts believe Golkar will fall to third behind Miss Megawati's Indonesian Democratic Party of Struggle, whose support has stalled at about 18%. So Golkar's leader, the current vice-president, Jusuf Kalla, will remain on the Yudhoyono ticket.

Islamist parties won about a third of the vote in 2004. But they are leaderless and feel compelled to move to the centre to attract votes. The Prosperous Justice Party, the most orthodox and popular group, has made tactical blunders and is unlikely to win more than 10% of the votes.

The greatest excitement is being provided by Prabowo Subianto, a former son-in-law of Suharto and head under him of a notorious special-forces unit accused of many atrocities over the years. His military career foundered after Suharto's downfall. But backed by his billionaire brother, Hashim Djojohadikusumo, he formed the Great Indonesia Movement Party (Gerindra) last year. It is waging a slick, populist campaign

aimed at the mass of poor voters. Gerindra may well win enough votes for Mr Prabowo to join Mr Yudhoyono and Mrs Megawati in an unlikely three-cornered presidential race.

China and America spar at sea

Naked aggression

Mar 12th 2009 | BEIJING
From The Economist print edition

With an Impeccable sense of timing

A RETIRED Chinese admiral likened the American navy to a man with a criminal record "wandering just outside the gate of a family home". The Chinese, said America's national intelligence director, Dennis Blair, had "become more aggressive" in asserting their maritime claims. Just as the two countries prepare for their presidents to meet, bickering has broken out. It is unclear whether it is over some silly local muscle-flexing, or a deliberately engineered provocation.

It would all sound familiar to George Bush, who faced a similar spat with China soon after becoming president eight years ago. Then, as now, the argument is about American military activity in China's vicinity. For Mr Bush, the mid-air collision of a Chinese fighter with an American spy plane in April 2001 became the first foreign-policy crisis of his presidency. For President Obama, a stand-off in the South China Sea between an American naval ship and five Chinese vessels is not such an emergency. In 2001, a Chinese pilot died and the 24 members of the spy plane's crew were held for 11 days. No one was killed or captured this time.

It is a reminder, however, that for all the talk of friendship China can still get very prickly. According to the Americans, their unarmed ship *Impeccable*, under naval supervision but with a civilian crew, was peacefully surveying the ocean floor in international waters about 120km (75 miles) south of China's Hainan Island (see map). Five Chinese boats—naval and civilian—approached her on March 8th. Chinese sailors reportedly waved Chinese flags and told the *Impeccable* to leave. The *Impeccable* turned fire-hoses on one boat to stop her getting too close. Chinese sailors stripped to their underwear as their boat closed in. Two of the Chinese boats forced the *Impeccable* to do an emergency stop, before she eventually withdrew.

The Chinese say the *Impeccable* was on a spy mission. Detecting submarines is indeed one of her roles, and Hainan is home to Chinese submarine bases. Moreover, says China's foreign ministry, the vessel was in China's exclusive economic zone. It accused the *Impeccable* of violating international and Chinese law. The Americans said it was the Chinese who had broken international law by not respecting the safety of a "lawful" ocean user.

Mr Blair said the incident was the most serious since the 2001 affair. According to the Pentagon, it was the

latest in a series of incidents this month involving Chinese harassment of American naval vessels, about which the Pentagon had kept diplomatically quiet until the latest encounter. Neither country will want to let the quarrel disrupt the preparations for Mr Obama's meeting with his Chinese counterpart, Hu Jintao, in the margins of the G20 summit in London in April. It will be their first face-to-face meeting, though Mr Obama spoke to the Chinese president by phone soon after taking office. China's foreign minister, Yang Jiechi, on a visit to America to prepare for the summit this week agreed with his counterpart, Hillary Clinton, that their countries should work together to ensure such incidents are avoided. During a visit to Beijing last month, Mrs Clinton said she did not think it realistic to expect global economic recovery without Chinese and American "co-operation and leadership".

Military co-operation is another matter. Talks between the two sides' armed forces resumed last month after a five-month suspension imposed by China in protest over American arms sales to Taiwan. American officials remain wary of China's secretive naval build-up, which is likely to intensify. A Chinese admiral said recently that it was "very necessary" to build an aircraft-carrier—a move that would heighten American unease. Further close encounters in the western Pacific are inevitable, and could always, and quickly, turn nasty.

A missing Thai human-rights lawyer

More questions than answers

Mar 12th 2009 | BANGKOK
From The Economist print edition

An unsolved abduction case raises difficult questions about the Thai security forces

AS A human-rights lawyer, Somchai Neelapaichit never shied away from tough cases. For over 20 years he successfully defended suspects, mostly fellow Muslims, against criminal charges that ranged from arson to treason. His work frequently took him to the restless, Muslim-dominated far south of Thailand, where for five years the army has been fighting a separatist insurgency. But he called Bangkok home.

On March 12th 2004 Mr Somchai himself became a victim of injustice. A group of men bundled him into a car in Bangkok, then drove away. Two days later, his wife, Angkhana Neelapaichit, filed a missing-person complaint, the first of scores of letters, appeals and petitions she would write in search of the truth about her husband's fate. "My duty", she says, "is to tell the story, again and again."

Five years on, Ms Angkhana is still waiting for answers. And, to add insult to injury, the security forces recently raided the office of her human-rights group, which compiles details of abuses in the south. An army spokesman claimed that they were looking for insurgents.

Mr Somchai is presumed dead. Of five police officers accused of involvement in the case, all but one were acquitted of theft (of Mr Somchai's car) and coercion. The convicted officer was freed on appeal and recently declared to have vanished. That Thai law-enforcement officials had a hand in an unlawful abduction is, sadly, no great surprise. Two days before he vanished, Mr Somchai had formally accused the police of torturing five Muslim men in custody. The men were arrested after a raid on January 4th 2004 on an armoury in the south; that event marked the start of the insurgency, which has since killed over 3,500 people, mostly civilians.

Like his predecessors, Abhisit Vejjajiva of the Democrat Party, who became prime minister last December, has promised justice and peace in the south. The number of violent incidents fell sharply last year after a military surge, but has risen again recently. The shadowy movement behind the shootings, bombings and gruesome beheadings keeps regenerating.

Critics say that although the free hand the army enjoys in the area seems to have been effective in dampening the violence, it is stoking the anger and alienation on which the insurgency feeds. Under emergency laws that Mr Abhisit extended in January, the 14th such extension since 2005, detainees can

be held without trial.

Thailand’s counter-insurgency tactics allegedly include the torture of detainees. Mr Somchai accused the police of using techniques such as electrocution and simulated strangling. The same issue has also caused controversy over Thailand’s close ties with America. Back in 2003, Mr Somchai rushed to defend three southern Muslims detained on suspicion of plotting with Jemaah Islamiah, a regional affiliate of al-Qaeda. All were later acquitted.

The arrests came as the prime minister at the time, Thaksin Shinawatra, flew to Washington to pledge allegiance to President Bush’s “war on terror”. At the time, the two cold-war allies were busy with the CIA’s “rendition” programme, which reportedly entailed questioning foreigners in Thai military jails. The CIA has admitted that it destroyed 92 tapes held in Thailand of such interrogations—leading to accusations that it did so because of the abuses that took place. The Thai army denies hosting any CIA jails.

Pressed by Ms Angkhana, Mr Abhisit has promised progress on Mr Somchai’s case. Forensic experts are scouring a possible dumping-ground for bone fragments. Another line of inquiry might be to retrace the steps of the five accused policemen, whose trial was criticised by foreign observers as deeply flawed. Hair samples in the victim’s car were never compared with the defendants’. Nor were the suspects’ mobile-phone records thoroughly checked, though it is known that on the day of the abduction one call was placed to the offices of the prime minister, Mr Thaksin. Ms Angkhana says she wants to see Mr Thaksin, who has offered conflicting accounts of Mr Somchai’s fate, brought in to answer questions. That seems unlikely: he is already on the run from a conviction in Thailand for corruption.

North Korea

Sound and fury

Mar 12th 2009 | TOKYO
From The Economist print edition

But signifying something?

Illustration by Claudio Munoz

IT CANNOT be said that it failed to warn them, for this week its propaganda organs reached a note of shrillness unusual even by North Korean standards. Charging that traitorous South Korea and the United States were bent on a "second Korean war", North Korea declared that it would take "every necessary measure" to defend itself. It was a "touch-and-go situation in which nuclear war may break out at any moment". Kim Jong Il has put his 1m-strong armed forces on a state of high alert, cut the military hot line to the South and, for a day at least, stopped South Korean managers from crossing the border to the Kaesong industrial enclave where North Korea experiments with capitalism.

Yet South Korea and America are far from preparing for war. They are merely conducting annual joint military exercises. These are a little larger than usual, admittedly. But as if to emphasise their defensive nature, the public face of the American armed forces has been a naval officer of unthreatening portliness.

They are, however, watching North Korea closely. It appears to be preparing a long-range Taepodong-2 missile for launch in early April. This would be the first launch since an unsuccessful test in 2006. The regime claims to be sending a satellite into orbit and has notified the International Maritime Organisation of its plan. But the same missile, if carrying a warhead, is capable in theory of reaching Hawaii or Alaska. A launch would breach United Nations sanctions on North Korea. President Barack Obama's new special envoy for Korea, Stephen Bosworth, has said merely that it would be "ill-advised".

Not for the first time, Mr Kim appears to be trying to get a new administration's attention and put his stamp on proceedings early in Mr Obama's term in office. American policy towards North Korea is not yet set. Mr Bosworth himself is critical of the early hostility of Mr Obama's predecessor, George Bush, arguing that it quickened the development of Mr Kim's nuclear programme. Engagement, he believes, offers the only hope of getting the country not only to dismantle its nuclear capability but also to develop the economy. Yet in Washington experts are suggesting everything from accepting North Korea as a nuclear state to bombing its facilities.

Mr Kim's regime is also livid that South Korea's President Lee Myung-bak has made aid conditional on progress over nuclear issues. A possibly greater flashpoint than the missile launch is a disputed maritime boundary to the west of the Korean peninsula. North Korea has provoked deadly naval skirmishes there before.

The shrillness may disguise disagreement in Pyongyang about how to deal with Mr Lee and Mr Obama. On March 9th the state media announced the results of parliamentary elections. In Constituency 333, every eligible adult cast a vote for the same candidate, one Kim Jong Il. Elsewhere, say Pyongyang-watchers in Seoul, notable hardliners were promoted.

Afghanistan's Uruzgan province

The Dutch model

Mar 12th 2009 | TIRIN KHOT
From The Economist print edition

The flower-strewers partly vindicated

AMID the gloom of recent assessments of the progress of its war in Afghanistan, NATO has seen a flicker of light in an unexpected province: Uruzgan. This 8,000 square-mile (20,000 square-kilometre) tract of the starkly beautiful Afghan central highlands is fast becoming its star performer. If the optimism is justified, it would be a vindication for the Netherlands, which took control of Uruzgan in 2006, deploying 2,000 soldiers, and has faced sniping from NATO's bigger powers ever since.

Uruzgan was the birthplace of the Taliban leader, Mullah Omar, and is dominated by the conservative ethnic Pushtuns from whom the Taliban draw their strength. Yet the Dutch forces lost only six soldiers killed in 2008, while the British in neighbouring Helmand lost 51 dead and Canadian forces in Kandahar lost 32 soldiers. Critics claim the Dutch are good at being a "best friend" to local people, but less convincing as a "worst enemy" to the Taliban: "flower-strewers". Dutch commanders put it differently. Brigadier-General Tom Middendorp, the Dutch commander, denies his soldiers avoid combat. They have been in more than 1,000 firefights since 2006. But Dutch priorities are to engage local people and help them with development.

Dutch army commanders have pursued an "ink-spot" approach, in which they focus on controlling the three central districts where 70% of the 627,000 population is concentrated. Other areas have been ceded, they say, until they can win popular support by demonstrating progress in the centre. General Middendorp points to recent success in the Baluchi Valley as proof that a "population-based" approach is bearing fruit. Dutch forces fought a long battle in the valley in late 2007, built patrol bases at either end of it and then stood back for a year, content to study the complex dynamics of the area from afar.

They were then able in late 2008 to occupy the whole valley without serious opposition. Grudgingly, local people concede there has been some improvement. Haji Zal, a tribal elder in Tirin Khot, the provincial capital, points to better security and new roads, and judges things "10%" better than a year ago. Other locals say much of the progress is due to the more robust Australian and American special forces who operate alongside the Dutch: "The only time the Dutch are fighting is when they are in bed and dreaming," sniffs one local police commander. But with fewer fights come fewer local civilian casualties and, suggests Thomas Rutting, an analyst in Kabul, less local hostility to the Dutch.

Afghanistan, however, has a history of turning success stories into horror movies. Khost province, for example, used to be held up by American commanders as a model, until apparently lasting progress crumbled last summer. Similarly, Dutch achievements will be tested by the summer spike in insurgent violence. The Afghan army's commander in Uruzgan, General Abdul Hamid, says the Taliban use remote districts of Uruzgan as training areas. So they have a reason to "live and let live" for now. He estimates local insurgent numbers at around 1,700.

But General Middendorp argues that the Taliban are less of a threat to the tottering structures of the Afghan state than feuding local tribes and predatory warlords. The Uruzgan insurgency is mixed up with a notably vicious tribal war between the Popolzai tribe and minority Ghilzai tribes. Jan Mohammad Khan, a Popolzai warlord and former Uruzgan governor, marginalised the Ghilzais. This seems to have created lasting turmoil which is exploited by the Taliban. NATO commanders have begun talking not of the "Taliban" but of "anti-government militias".

Since the Dutch arrived, the number of Uruzgan children in school has risen from 12,000 to 50,000; 100 health centres have been built; there are 31 doctors, up from just two; and infant mortality, still a horrifying 25%, has fallen from 36%. General Middendorp is upbeat, but admits the place is still like "the

Old Testament". To secure lasting change, even if security improvements are retained, will take decades. The illiteracy rate is well over 80%, corruption is endemic and tapping the limited pool of educated bureaucrats in Kabul for officials to come and run Uruzgan is currently all but impossible.

For the Dutch, success in Uruzgan may help to lay the ghost of Srebrenica, where their peacekeepers stood by in 1995 during a massacre. But they are in a hurry to go—by 2010, according to the Dutch government. And despite progress in building Afghanistan's fledgling armed forces, it is unclear who will replace them.

Kenya

Next machetes, then machineguns?

Mar 12th 2009 | NAIROBI
From The Economist print edition

AP

Corruption at home and recession abroad threaten a shaky coalition

THE recent shooting of two prominent Kenyan human-rights campaigners in broad daylight in Nairobi, the country's capital, has darkened the national mood just when Kenya's fragile coalition government is showing signs of stress and the global recession is beginning to batter the economy anew. The campaigners, Kamau King'ara and Paul Oulo, had been investigating death squads widely thought to be linked to senior politicians, so it was immediately assumed that the pair had been silenced by orders from on high.

Mr King'ara had said that at least 1,700 young Kenyans had been shot or tortured to death by death squads during President Mwai Kibaki's first term in office between 2002 and 2007, while another 6,500-plus had disappeared, probably also at the hands of government goons. His was not an isolated allegation. Last month Philip Alston, a UN investigator, published a report documenting around 500 death-squad executions in the months leading up to the election of December 2007, whose disputed results led to 1,500 or so deaths and the displacement of at least 300,000 Kenyans in the subsequent violence. Mr Alston, an Australian, called for the chief of police, Hussein Ali, and the attorney-general, Amos Wako, to resign. They show no sign of doing so.

Hours before the two campaigners were killed, the government's spokesman accused Mr King'ara of raising funds for the feared Mungiki, a gang of thugs (mainly Kikuyus, members of Kenya's largest and richest ethnic group) who have terrorised people in the area around Nairobi for several years. Human-rights groups say this is nonsense, and Mr Alston has called for an independent investigation into the killings. Raila Odinga, prime minister in Kenya's increasingly shaky coalition government, said America's FBI should be called in, a suggestion perhaps designed to embarrass security ministers in Mr Kibaki's part of the coalition.

Speculation as to the killers' motives abounds. Some suggest that policemen suspected of setting up and running the death squads were furious that they were being investigated, especially since the politicians who are presumed to have given the go-ahead have got off scot-free. A death-squad member had already been hunted down and killed after blowing the whistle. A local investigative journalist was beheaded, possibly by the police.

Apologists for Kenya’s Criminal Investigation Department and other units say the police have been performing a patriotic duty. Most of the murdered men whose cases were documented by Mr Alston were suspected of having sworn an oath of allegiance to the Mungiki, who attract their young adherents with a blend of Kikuyu revivalism, nostalgia for anti-colonial Mau Mau rebels, Jamaican and American street culture, and community action. Some say the death squads were told to wipe out a generation of Mungiki leaders to ensure that poor young Kikuyus stay loyal to Mr Kibaki, who heads the old Kikuyu establishment. The police also wanted to curb the Mungiki’s crimes, particularly their habit of extorting money from bus drivers and passengers. Mr Alston’s findings have been well received by the Mungiki, who have since held marches in Nairobi and smaller Kikuyu-populated towns.

If they mutate from being tribal chauvinists into class warriors, the Mungiki may start to menace the old guard. The rising cost of food, soaring unemployment and the grimness of life in the huge slums abutting central Nairobi may open up space for a potent new movement that could cut across ethnic lines. “A thousand death squads won’t deal with all these angry young men,” says a local observer.

In any event, the grand coalition government put together less than a year ago after the disputed elections may be buckling under the weight of its own inadequacy. Corruption and mismanagement are still rife. The government has created an “eat-and-let-eat” dispensation, with officials from both ends of the coalition pilfering the country’s resources. Even if it were being well governed, Kenya would have to sprint just to stand still, since the population is continuing to balloon; from less than 8m at independence in 1963, it now exceeds 37m. The infrastructure continues to fall to bits, health care and education are patchy. Land reform, a topic that stirs angry feelings, particularly between competing ethnic groups, has still not been addressed.

Some 4m Kenyans now rely on food aid. The number in absolute poverty is up. So is unemployment. The Kenyan shilling is overpriced and set to be sharply devalued. The government cannot meet its budget targets. Banks and mobile-phone firms enjoyed big profits in 2008 but manufacturing and tourism will dive as the global recession bites. Kenya’s exports of cut flowers, coffee, tea and fruit may shrink.

If the economy were less grim, the shenanigans of the country’s politicians might be amusing. Instead, they are making Kenyans feel bitter. Mr Odinga’s Orange movement has threatened to leave the coalition; its leaders say it is stuck in a “marriage without conjugal rights”. Then off you go, say the allies of President Kibaki, whose Party of National Unity has the choicest ministries. Far from giving a lead when he recently held a rare press conference, Mr Kibaki merely took the opportunity to declare that he was no polygamist.

Messrs Odinga and Kibaki have both broken promises to deliver politicians and businessmen who stirred up violence after the elections of 2007 for trial in Kenya or the International Criminal Court in The Hague. Several detailed reports have named a slew of senior figures on both sides of the political divide. A growing fear is that the next crisis may see an escalation from machetes to machineguns. It is by no means certain that Kenya’s fragile political peace can last until the next general and presidential elections, due in 2012.

Nigeria's economy

A double strike

Mar 12th 2009 | LAGOS
From The Economist print edition

Africa's second-largest economy has home-grown problems, too

STAND on the beachfront of Lagos, Nigeria's commercial capital, and a puzzling scene emerges from the tropical haze: a stately line of container ships, each at anchor, queuing to enter the harbour. Despite the global slump, congestion is not letting up, says the director of the company that runs the privatised port. The number of inbound containers has doubled in the past three years; so far in 2009 there has been no decline. Such is the crush in Lagos that getting cargo from ship to port to lorry still takes an average of six weeks.

Such blockages are nothing to celebrate. But they indicate how 140m-odd Nigerians, despite being battered by a sharp fall in oil revenues and by an equally painful 20% devaluation of their currency, the naira, remain hungry for imports. Retailers tell a similar story. Coca-Cola plans to serve Nigerians over 2 billion bottles of sugary drinks this year, as it did last year. Procter & Gamble, which sells nappies, washing powder and so on, reports some slackening growth but still expects the young and fast-growing population to push up consumer demand in the next few years. Mobile-phone companies, notably MTN, which dominates the local market, are even more gung-ho. They continue to brag about healthy sales of handsets and new armies of subscribers, though the rising costs of imported equipment cut into profits; Nigeria now has some 64m lines, up from a handful a decade ago.

Anecdotally, at least, businessmen's bullishness seems so far to be borne out. Good hotels in Lagos still charge astronomical rates, building sites are crowded and vendors throng the city streets as ever; bootleg DVDs of Barack Obama's inauguration are particularly popular.

But like many poor countries (see article), Nigeria has not escaped the global storm. It relies heavily on oil and gas exports, which provide more than 95% of all foreign-exchange earnings and most of the government's revenue. Both have been thumped by the tumbling price of crude, now at about $40 a barrel, more than $100 less than at last year's peak. With nothing else to export—all those containers leave empty—Nigeria is especially vulnerable to volatile oil prices.

Capital which washed merrily into the economy a year or two ago is flowing the other way. Most of it had served the hydrocarbon industry but some foreign investors, notably Americans, had started to see Nigeria as an emerging market; braver ones were tempted by its stockmarket. No longer. A property bubble has popped; the Nigerian Stock Exchange has tumbled by around 40% from its peak. Speculators and local banks are painfully out of pocket.

No wonder the federal government is starting to sound worried. On March 10th President Umaru Yar'Adua at last signed into law a much-delayed expansionary budget, with spending for 2009 at $21.2 billion, a lot more than in early drafts. The newish finance minister, Mansur Muhtar, recently admitted to a meeting of businessmen in Lagos that he saw a "very gloomy picture in the short and medium term".

Nigeria, along with Africa as a whole, should be spared outright recession. Chukwuma Soludo, the central bank's governor, says he still expects sub-Saharan Africa's economies to grow by roughly 3% this year. Nigeria, he reckons, should muster more than that, though not the 6%-plus of recent years. That would barely match the rate of population growth, but if those figures are right Nigeria will be doing better than most and should avoid the acute pain of previous commodity-price busts, as in the 1980s, when the government could not pay civil servants and political instability ensued.

Nigeria is also in better shape to deal with a slowdown because of some decent macro-economic reforms. Inflation, food aside, is quite low. The government has paid off sizeable debts or been relieved of them. It also has ample foreign-exchange reserves and has ferreted away $20 billion in a fund called the Excess Crude Account, which will help cushion public finances from the downturn. On the other hand, raising cash is getting harder: Mr Muhtar has just postponed plans to sell $500m of bonds on the international

market.

Trouble at home

Yet even if the global crisis has not hit Nigeria as hard as elsewhere, it is exposing some unresolved problems at home. Take the banking system, which Mr Soludo says would have collapsed months ago but for an early round of government-driven consolidation. He calls the banks "shock absorbers" for the economy. But they look increasingly wobbly. Despite claims that they are well capitalised, with generous capital ratios of 22% said to be typical, they have all but stopped lending to each other or to local firms, especially smaller ones.

Critics say the banks are frozen because many are dangerously exposed to the stockmarket slump, after rashly securing a large portion of their loans with now almost worthless equities. Without government support, some banks would almost certainly fail. None trusts the others.

Oil and gas production, the economy's mainstay, is also in bad shape. Long Africa's biggest producer, Nigeria last year ceded the top spot to Angola. Production is dropping, in part, because militants in and off the Niger Delta kidnap workers and scare away oil firms. A new pipeline built to export gas to Ghana, Togo and Benin should have opened in January but lies empty. Talk of spending $12 billion to build another pipeline running 4,400km north across the Sahara to send gas via Algeria to Europe sounds fanciful. A sizeable share of local gas is simply flared off at source.

Meanwhile, Nigeria still cannot keep its own lights on. Manufacturers, who account for a feeble 3-4% of GDP but at least create some jobs, grumble that they must rely entirely on costly diesel generators. Power cuts are common. It has long been obvious what should be done: existing turbines lack supplies of gas, transmission cables should be rolled out, more power stations must be built. Successive governments have let power generation dwindle, yet none has let private contractors act instead. Shortly before leaving office the previous president, Olusegun Obasanjo, passed a law ordering the privatisation of some power stations. But Mr Yar'Adua quickly reversed this, saying he was worried about corruption.

A rare bright spot is agriculture. Nigeria's lands are fertile; water, at least in the south, is plentiful. A fertiliser plant has been privatised and is supposed to start supplying farmers. Local food and tobacco prices remain high compared with world prices, which should give farmers good incentives. One day—who knows?—goods may once again flow out of Lagos harbour as well as into it.

Lagos

The Big Yam

Mar 12th 2009 | LAGOS
From The Economist print edition

Plotting a pleasanter future for Nigeria's business capital

Reuters

Governor Fashola says it's getting better

SPEND an evening at the tree-lined Seaside Bar on Ikoyi Island and it is possible to come away with a rosy view of Lagos. Revellers clink bottles and gaze across shimmering water. A motor-cruiser festooned with twinkling lights swishes by, music booming. Spotlights illuminate a row of plush new waterside flats on neighbouring Victoria Island; cranes, radio masts and fast-rising hotels dot the skyline.

Daily reality is less alluring. Lagos has long suffered from overcrowding, jammed and broken roads, erratic supplies of power, violent crime, floods, filth and smog. Lagosians are often dynamic, thrusting and entrepreneurial—but even some locals concede that their city is exhausting. Stretched awkwardly over islands and swamp, Nigeria's former capital struggles to serve both as west Africa's finance-cum-business hub and as one of the region's biggest ports.

It has fast outpaced efforts to plan for growth. A recent census found 8m residents, making Lagos Africa's most populous city after Cairo; the UN expects that figure to reach 20m by the end of the next decade. The governor of Lagos state, Babatunde Fashola, thinks it will get even bigger. Bedecked in a traditional outfit topped by a jaunty red cap, he says that Lagos must plan to be a "mega-city" of 40m souls by mid-century.

What chance has he of crafting a functioning city rather than a conurbation of slums? In office for two years, Mr Fashola can claim a little progress. "We have been able to make the wheels turn quicker," he says, pointing to new roads, more traffic lights, street lamps and wardens. Now he has plans for public transport: a fleet of 40,000 fume-belching buses, he says, will be overhauled and two commuter rail lines built with the help of private contractors. Ground is due to be broken for the railway in August, as contractors bid for business. The first trains, he promises, will be trundling within three years.

Crime, including armed robbery, is down sharply, he says. Illegal housing has been cleared from the city centre, in some places replaced by parks and trees, so crooks find it harder to evade police. Mr Fashola also points to new cars, boots, CCTV cameras and increased allowances for the city's 3,000 police. Robbers in boats who once whizzed along city creeks have been chased away.

Efforts are being made to stir up civic pride and reduce the smog caused by fires, by collecting rubbish and waste more reliably. Mr Fashola is also committed to fighting graft; he has published his e-mail address and telephone number for complaining Lagosians.

So far, locals are fond of their governor and his populist touch. He benefited when the economy boomed. But falling oil revenue will mean less public money in the next year or two, and the private sort will be harder to raise too. He plans a fund worth 50 billion naira ($340m) to pay for public-private partnerships to upgrade local power stations, run new train companies and so on. But as the world economy slumps, private partners may be hard to find—and his popularity trickier to sustain.

South Africa

Shaik, rattle and release

Mar 12th 2009 | JOHANNESBURG
From The Economist print edition

When the definition of dying becomes part of a political scandal

SOUTH AFRICANS are agog. In recent years they have seen a lot of shenanigans to do with the ruling African National Congress (ANC), but the latest may top them all. Just two days after Jacob Zuma, the party's leader and South Africa's probable next president, said that, if elected, he would consider pardoning his former financial adviser, Schabir Shaik, the businessman was freed from prison, supposedly on medical grounds. Convicted in 2005 of corruption in a big arms-deal scandal, Mr Shaik had served only two years and four months of his 15-year sentence.

Mr Zuma, who is himself facing 18 counts of racketeering, corruption, money-laundering, tax evasion and fraud in connection with the same arms deal, was sacked as South Africa's deputy president soon after his friend's conviction. Mr Shaik was found to have given Mr Zuma more than 1m rand ($100,000) in bribes from a French arms company in a bid to influence the allocation of the contract.

According to Mr Shaik's doctors, he has depression and hypertension, which could lead to a heart attack, stroke or blindness at any time. Under the law, a prisoner "in the final phase of a terminal disease or condition", usually meaning he has less than six months left to live, may be released on medical parole to die a "dignified" death with his family. Even if he then stages a miraculous recovery, he does not return to jail.

Opinions differ sharply, however, as to whether Mr Shaik is truly at death's door. Though carried back into his Durban home on a stretcher, staff at the city hospital where he spent most of his incarceration have spoken of his walking around, eating hamburgers and happily chatting to visitors. The chief cardiologist says that Mr Shaik was well enough to be discharged from the hospital four months ago. But Ngconde Balfour, the minister for correctional services, insists that all three doctors who examined Mr Shaik for the parole board deemed him "terminally ill".

Even if Mr Shaik really is dying, he has got privileged treatment. More than 1,400 inmates die in South African jails every year without getting medical parole. Faced with a rising clamour for an independent investigation into another murky ANC affair, Kgalema Motlanthe, the country's interim president, has agreed—after resisting all such calls for ten days—to consider such a request "once it is submitted".

Arab diplomacy and the Palestinians

Try to avoid embarrassment again

Mar 12th 2009 | CAIRO
From The Economist print edition

Illustration by S. Kambayashi

Can the Arab world's leaders stop bickering and help forge peace in the region?

ARAB countries own the biggest share of the Middle Eastern sand pit. Yet their tendency to bicker among themselves keeps letting others grab the toys. The Arabs have looked on haplessly as America marched into Iraq, Israel clobbered Lebanon and Gaza, and their ancient rival Iran subtly spread its influence. But new challenges, plus a whiff of expectation that American diplomacy is about to change, are prompting a fresh effort by Arabs to resolve their disputes.

The challenges are daunting. They include the likelihood that Israel's next government, which looks set to empower parties on the hard right, will prove allergic to making peace; Iran's potential for going nuclear or fomenting unrest among Shia minorities in Arab countries; and the possibility that infighting among Palestinians could, in the short run, stall the delivery of aid to the wretched Gazans and in the longer run ruin the chance of a unified Palestinian state. Together, it is feared, these developments may pitch the turbulent region into a bitter new bout of chaos.

A more immediate prospect of embarrassment looms when the Arab League's 22 heads of state gather later this month for their annual summit. Another public rupture is the last thing they need as they try to coax Barack Obama into addressing their concerns more sympathetically than his often heedless predecessor.

This week in the Saudi capital, Riyadh, the kingdom's 84-year-old ruler, King Abdullah, hosted the similarly aged and American-allied leaders of Egypt and Kuwait, along with Syria's President Bashar Assad, a relative stripling who has fashioned himself as America's opponent. Egypt, Saudi Arabia and Syria were once pillars of pan-Arabism but Syria has drifted into an ever-tighter orbit around Iran, a country viewed by America's Arab allies as an alien meddler in their affairs. Mr Assad's older counterparts have also chafed at his sponsoring of Hizbullah, Lebanon's well-armed Shia movement, and of Hamas, the Palestinian Islamist party. The Saudis and Egyptians see these non-state actors as proxies for revolutionary Iran, whose brashness in insisting on fighting Israel may raise cheers from the Arab public but risks sucking their governments into unwanted conflict.

Like America itself, its Arab friends would like nothing better than to wean Syria off its alliance with Iran. Such has been the subtext of a growing barrage of Western overtures to Mr Assad, including a visit to Syria by the most senior American envoys since George Bush withdrew his ambassador in 2004. Britain's recent decision to open talks with Hizbullah is part of the same approach. Syria has so far denied any intention of distancing itself from Iran, judging that its strong ties, dating back to the 1980s, have served it well in strengthening its weak hand against Israel, which has occupied a slice of Syrian territory, the

Golan Heights, since 1967.

But the sudden defrosting of Syrian relations with the Egyptians and Saudis, whose own rhetoric against Iran has lately become more vehement, suggests that a far-reaching realignment could be in the making. Syria's attachment to Iran is tactical, not strategic, judges an Egyptian diplomat, pointing to the ideological disjuncture between Mr Assad's secular regime and Iran's aggressively Islamist one.

Cash always helps

Money may be a lever: the collapse in oil prices, plus rapidly dwindling Syrian production of the stuff, confronts Mr Assad with a fast-approaching budget crisis. Iran, mired in deficits, is in no position to help, compared to the still-flush Arab petro-monarchies. Besides, with Iran itself signalling a cautious welcome to better relations with America, the nimble Syrians are wary of ending up as the region's sole remaining wheel on the axis of evil.

Subtle shifts in Syrian policy are already detectable. The Syrian leader is likely to have infuriated Iran recently by quietly declaring his support for the United Arab Emirates in its long-running territorial dispute with the Islamic Republic over three islands in the Gulf. He has also said he would welcome direct peace talks with Israel on condition that America agrees to sponsor them and that Israel understands that he is looking for a comprehensive peace, not a separate deal that would leave Palestinians in the lurch.

No less significantly, Mr Assad appears to be edging away from his previous all-out backing for Hamas, whose Damascus-based leaders have often sounded more intransigent than their beleaguered peers in Gaza. Mr Assad recently stressed that he intended to keep an equal distance from all the Palestinian factions and to encourage them to pursue reconciliation between themselves in order to strengthen their international position.

This must please Egypt, whose tiring labours at this task may at last bear fruit. Representatives of Hamas, its secular rival Fatah, and smaller Palestinian parties gathered this week in Cairo for what Egyptian officials portray as make-or-break talks to forge a transitional government ahead of an election next January. At daggers drawn since Hamas followed its election triumph over Fatah in 2006 with a pre-emptive coup in Gaza in 2007, the rivals have feuded bitterly and violently.

But delegates to the Cairo meetings, who were split into committees to tackle specific issues, reported cordiality and progress. If, as the Egyptians and Fatah would like but Hamas has so far opposed, the Palestinians concoct a cabinet of technocrats rather than ideologues, Gazans may get their aid and peace talks with Israel may resume. And perhaps, when Arab kings and presidents meet in Qatar later this month, their smiles will be genuine.

The state and the economy: Germany

How to restart the engine?

Mar 12th 2009 | BERLIN
From The Economist print edition

Illustration by Peter Schrank

European governments are taking over ever-larger parts of the economy. In the first of two articles, we examine the debate in Germany

FOR German leaders nowadays, Rüsselsheim is an obligatory destination. Frank-Walter Steinmeier, the foreign minister who is campaigning to become chancellor in September, showed up last month. His mission: to reassure workers at Opel, an ailing carmaker based in Rüsselsheim, that the government will fight for their jobs. "Opel must live!" cried the normally circumspect minister before a crowd of 10,000 people. The chancellor, Angela Merkel, who hopes to be re-elected, plans a pilgrimage later this month.

Sorting out Opel's fate has become the most pressing question in German politics. The company is part of the German arm of America's nearly-bankrupt General Motors, which says it needs €3.3 billion ($4.2 billion) to survive. Mr Steinmeier's Social Democratic Party (SPD), and members of the conservative Christian Democratic Union (CDU) whose constituents include most of Opel's 29,000 workers, want to rescue the company at almost any cost.

On the other side are economic liberals who fear that the state is already taking over too much of the economy. Some worry that Germany risks becoming something of a socialist state—"East Germany lite", in the words of Guido Westerwelle, head of the opposition Free Democratic Party (FDP).

Germany's post-war prosperity (first in West Germany, then haltingly across the country after reunification) was founded partly on the notion of *Ordnungspolitik*, whereby the state referees the market without seeking to control it. It would intervene in some areas, for instance to prevent monopolies, but stay out of other domains, such as setting wage levels. This arrangement largely succeeded in making a success of Germany's "social market economy". To the dismay of economic liberals, however, the "grand coalition" government, in which Ms Merkel's CDU is yoked to the SPD, had been chipping away at *Ordnungspolitik* even before the crisis, for example by introducing minimum wages in some sectors.

Now it is going further. The government plans to spend €80 billion to stimulate demand and has made €500 billion available to rescue banks. It has created a €100 billion "Germany Economy Fund" to provide credit and loan guarantees to non-financial companies, perhaps including Opel. And it is proposing a law

that would let the government expropriate failing banks as a last resort.

Few doubt that the banking system needed rescuing. But the risks of bailing out industrial firms are "much more severe", says Justus Haucap, head of the Monopolies Commission, which advises the government. These include distorting competition, weakening healthier companies and preserving outmoded methods of production. The costs could mire the government in large debts; the worry may be not that the state will become too powerful, but that it will become severely weakened. "The growing fear that the bail-out state will be overburdened could decide the election," commented a recent editorial in *Frankfurter Allgemeine*, a conservative newspaper.

That said, there are fewer purists in politics these days. Even Mr Westerwelle's FDP concedes that aid to industrial firms may sometimes be warranted. The fights are over nuances: what sort of aid, to which firms and under what conditions? The government's policy, officially at least, is that only firms that are in trouble through no fault of their own and have credible plans for recovery will qualify for aid, and then only in the form of loans or guarantees.

Opel so far has failed these tests. It has been losing market share for years and may be too small to survive in an industry plagued by overcapacity. The economy minister, Karl-Theodor zu Guttenberg, says Opel's 184-page survival plan still leaves many questions unanswered. Waiting in the wings is the equally undeserving Schaeffler, a car-parts manufacturer which borrowed €11 billion to buy a larger rival, Continental (see article).

The crisis is polarising politics. The SPD is gaining in the polls, thanks in part to its advocacy of state intervention, which appeals to its core voters. At the same time, the unabashedly free-market FDP is enjoying record ratings of 15% or more.

The CDU is caught in a pincer and is being split. Roland Koch and Jürgen Rüttgers, the CDU premiers of Hesse and North Rhine-Westphalia, would contemplate temporary state ownership of Opel to save factories in their states.

The chancellor has not sided with them, but nor has she vigorously opposed them. That angers the party's liberal wing, which grumbles that she is too ready to follow the lead of the left-leaning SPD on company bail-outs and bank takeovers. "We have to avoid giving the impression that the CDU is the party of nationalisation," says Gunther Oettinger, Baden-Württemberg's premier.

Ms Merkel, who grew up in East Germany, is unlikely to wish for the return of state control of the economy. "At the end of this process we can go back to the old contours of the social market economy," she says. The interventions in the economy so far have been limited. The Germany Economy Fund runs out next year (though its guarantees will linger). The bank-expropriation bill leaves the government just enough time to take over one bank, Hypo Real Estate, into which it has already pumped more than €100 billion.

A planned constitutional amendment would bar states from running deficits and would limit federal budget deficits to 0.35% of GDP, beginning in 2016. As the economy recovers, this should ensure that public spending will shrink as a share of GDP, says Michael Eilfort of the liberal Market Economy Foundation in Berlin. For now the government's plan is to return to *Ordnungspolitik* once the crisis has passed. But if it deepens, is there a Plan B?

The state and the economy: France

Back in the driving seat

Mar 12th 2009 | PARIS
From The Economist print edition

The return of dirigisme

Illustration by Peter Schrank

IN ONE respect, at least, the global downturn is welcome in France: it has legitimised economic interventionism in the land where Louis XIV's finance minister, Jean-Baptiste Colbert, invented it under the term *dirigisme*. "The main feature of this crisis", declared President Nicolas Sarkozy recently, with more than a hint of satisfaction, "is the return of the state, the end of the ideology of public powerlessness."

The government's recent €6 billion ($7.6 billion) rescue of Renault and PSA Peugeot Citroën, two carmakers, captures the French political mood. It prompted little debate over whether the state should bail out car manufacturers with public money, or even whether such state aid would distort competition. Such arguments were left to the European Commission, as well as to central and eastern Europeans livid at protectionist comments made by Mr Sarkozy, who suggested last month that it was "not justified" for a French carmaker to build a factory in the Czech Republic in order to sell cars in France. At home, though, barely a voice was raised to recall that the freedom for companies to do this is enshrined in Europe's single-market laws.

Instead French politicians, from the left and the right, have urged Mr Sarkozy to do even more to protect French jobs, keep factories open and curb bosses' pay. The car industry directly employs 700,000 people in France, and 2.5m indirectly. With unemployment already at 8.3%, and global car sales collapsing, the French are particularly worried about job losses and stagnant pay. Unions have called for another day of strikes and protests on March 19th; the latest day of action in January drew 1m-2.5m people onto the streets across France.

This is why Mr Sarkozy tried so hard to tie state aid for the car industry to a promise to keep production at home. "We could not have explained to the French that we were spending money on companies but not saving jobs in France," says one minister. After meetings with car bosses, Mr Sarkozy announced triumphantly in February that he had got his way. Both Renault and PSA, he claimed, had given "a commitment" not to close any factories for the duration of the state loans, and to "do everything" to avoid layoffs. But Neelie Kroes, the EU competition commissioner, demanded a written promise that the aid would not be linked to any measures limiting carmakers' freedom in the single market, now or in the future. With that guarantee in her pocket, she gave the go-ahead.

French politicians consider as given a strong role for the state. If anything, the policies regarded in Brussels as protectionist are in France considered too liberal. Voices on the left charge that Mr Sarkozy has ceded too much to Brussels over the car industry. Even before the slump, economic liberals were a discrete species in the French political ecosystem, dominated by the traditional big beasts of the Gaullist right and the Socialist left. The anti-capitalist hard-left is enjoying fresh popularity. A recent *Paris Match* poll suggested that the three far-left political parties, a mix of communists and Trotskyites, would together grab 16% of the vote at the upcoming elections to the European Parliament—more than the centrist party of François Bayrou.

Indeed, many in France have found renewed pride in their statist system. *Le Monde* noted in a recent article that, "In the crisis, the French model, formerly knocked, is finding favour once more," and argued that "France is better equipped than the United States or some of its European partners to deal with the recession, because its model limits social damage." François Fillon, the centre-right prime minister, has praised the virtues of *dirigisme* in building high-speed trains and developing nuclear energy. The new

creed has notably raised the stock of Henri Guaino, Mr Sarkozy's speechwriter and a long-standing advocate of state intervention.

Even Christine Lagarde, the free-market finance minister, points out that the heavy state now has its advantages. In 2007 public spending accounted for 52% of GDP in France compared with 45% in Britain and 44% in Germany. This may have held back the economy in boom times; but, with its welfare cushion, it helps to keep it afloat in recession. Once denounced for running a high budget deficit, France now has one which, at 5.5% of GDP forecast by the IMF for 2009, is well below that of Britain (7.2%) and the United States (12%).

During his election campaign, ironically, Mr Sarkozy had called for reforms to the French model which, he said, produced less growth and more unemployment than elsewhere in Europe. The recession took hold just as he launched measures to trim the civil service, stiffen competition, cut red tape and loosen the labour market. Now he is under pressure to ease off.

Yet in the long run, many of those policies are needed. "The French economy and, above all, the French consumer appear to be relatively resilient in the presence of shocks," wrote Carlos Caceres, an economist at Morgan Stanley, in a research paper this week. "However, this resilience stems mostly from structural rigidities—in particular labour-market rigidities—which prevent the economy from adjusting rapidly, and therefore can come at the cost of a more protracted downturn."

Italian justice

Silvio, the actress and the law

Mar 12th 2009 | ROME
From The Economist print edition

Suspicions surround Italy's attempt to reform the judiciary

THE story of Silvio Berlusconi's lobbying to secure television parts for glamorous actresses is one of the more strange and memorable tales of the Italian prime minister's colourful history. In 2007 an Italian newspaper published leaked transcripts of telephone calls between Mr Berlusconi, then leader of the opposition, and a senior executive at Italy's public broadcaster. In one of them Mr Berlusconi, seeking to upset the centre-left government's narrow majority in the upper house, is quoted as explaining that "I'm trying to get the majority in the Senate". One voluptuous actress has "been requested from me by someone with whom I am negotiating".

The inevitable suspicion was that Mr Berlusconi was trying to persuade legislators to defect by using the oldest bait in the book. On February 25th, however, the case was dropped. Prosecutors said there was insufficient evidence of wrongdoing for either Mr Berlusconi or the executive to be tried. On the same day, oddly, Mr Berlusconi's People of Freedom (PdL) alliance dropped some of the more draconian measures in a bill designed to limit wiretaps and reports of their contents.

The episode illustrates many of the misgivings that surround Mr Berlusconi in his latest effort to overhaul the legal system: is he really seeking to enhance Italy's poor standards of justice, or is he trying to protect his own interests?

All agree that the existing system is a nightmare: intrusive yet slow, costly and unpredictable. Its shortcomings are not just a matter of social fairness. They help explain why Italy attracts comparatively little foreign investment. According to a 2009 survey by the World Bank on the ease of doing business, Italy's judicial system offers investors less protection than does Mozambique's; contracts are more difficult to enforce in Italy than in Colombia.

Angelino Alfano, the justice minister, says it takes more than 31 months on average to bring a case to court; more than 5m civil and 3m criminal cases are pending. Money is part of the problem. The courts are poorly financed, and the limited money available is spent on too many small courthouses. In criminal trials, moreover, both defence and prosecution are allowed at least two appeals.

Saving money is one justification for the first proposed reform, which deals primarily with restricting wiretaps. Even Saverio Borrelli, the prosecutor who led the so-called *Mani Pulite* (Clean Hands) anti-corruption drive that swept away Italy's old political order 15 years ago, recognises that Italian investigators resort much too freely—and lazily—to telephone-tapping and eavesdropping.

The bill says a telephone tap would have to be authorised by three judges; they would need "evident" indications of guilt; and with the exception of Mafia or terrorism cases, it could not last more than 60 days. The judiciary's self-regulatory body has criticised earlier versions of the bill as "a serious obstacle to investigative activity"; it said it would benefit fraudsters, blackmailers and paedophiles. Under pressure, the government has removed some of the most controversial provisions.

Still, some remaining aspects worry journalists and lawyers, such as the stiff penalties suggested for the publication of wiretaps, part of a proposed news clampdown from arrest to indictment. Currently, prosecution evidence can be published as soon as it is handed to the defence. Innocent third parties can find their most intimate thoughts aired in public. But given the sloth-like pace of the courts, such British-style restrictions may mean that serious allegations are heard about only long after the event.

A second bill would overhaul the workings of the judiciary. Some steps, like curbing appeals, will help. But the main reform, splitting the jobs of prosecutor and judge, may make justice fairer but not swifter. One change, stopping the findings of one trial being applied to another one, would slow down proceedings. And it would also shield Mr Berlusconi after the conviction last month of his former lawyer, David Mills, on bribery charges.

School killings in Germany

Not just an American horror

Mar 12th 2009 | BERLIN
From The Economist print edition

Germany's strict gun laws could not prevent another teenage massacre

EPA

After the bloodbath

ANOTHER ordinary school. Another teenager with a dark soul and a gun. Another harvest of young corpses. This time it happened in Winnenden, a prosperous town of 28,000 near Stuttgart. On March 11th Tim Kretschmer, a 17-year-old boy clad in black military garb, marched into the Albertville-Realschule, from which he had graduated last year, and opened fire with a 9mm pistol.

He killed nine students (eight of them female), three women teachers and one person in front of a psychiatric clinic opposite the school, before fleeing with a hostage in a hijacked car. In a shoot-out with police at a Volkswagen dealership 40km (25 miles) away, he killed two more before apparently shooting himself.

For some time now, Germans could no longer regard school massacres as a characteristically American crime. In 2002, 17 people were killed at a school in Erfurt in eastern Germany. In Finland shooting sprees at two different schools in 2007 and 2008 left 20 people dead, including the perpetrators.

Germany, though, has one of the strictest gun-control regimes in the world, says Rainer Wendt, head of the country's Police Union. Gun-owners have to show that they can be trusted with weapons, demonstrate their need for them, register them with the police and keep them securely. Gun ownership is relatively high, at around 30 per 100 people, but well below the rate in the United States (89) and Finland (45), according to the Geneva-based Small Arms Survey. Despite such restrictions, Mr Kretschmer's parents owned an arsenal of more than a dozen guns, one of which he employed in the killing spree, according to German press reports. His father is a prosperous businessman.

Children who are prone to extreme violence often hint at it beforehand, but if Mr Kretschmer did so no one picked it up. He is described by officials as "completely inconspicuous" and had entered an apprenticeship programme, an attainment that eludes many disaffected young men. Tragedies like the one in Winnenden can unfortunately strike without warning, and perhaps anywhere.

Turkish foreign policy

Repairing the bridge

Mar 12th 2009 | ANKARA AND TEHRAN
From The Economist print edition

The diplomatic benefits of an undiplomatic outburst

WHEN Recep Tayyip Erdogan stormed out of a panel discussion with Israel's President Shimon Peres in Davos last January, denouncing Israel's offensive in Gaza and quoting the sixth commandment "Thou shalt not kill", many wondered whether he had just demolished Turkey's position as the bridge between the Jews and the Arabs, and between the West and the Islamic world.

He certainly won plaudits among many Muslims, not least Iran's President Mahmoud Ahmadinejad. Yet his outburst—and the rancour against America and Europe that many Turks now express—seem not to have done him any harm with the administration of Barack Obama. On the contrary, at a time when America wants to reach out to the Muslim world, Mr Erdogan's popularity may be useful.

After visiting London, Brussels and Prague next month, Mr Obama will travel to Turkey, keeping a pledge to visit a Muslim country in his first 100 days. Delighted Turkish officials see favourable omens: they say it will be the first time an American president has visited Turkey without also making an obligatory visit to its rival, Greece. They interpret Mr Obama's decision to visit as part of a European tour, rather than a Middle Eastern one, as confirmation of Turkey's importance in NATO and a message of American support for Turkey's wish to join the European Union.

One senior official spoke of a new "golden era" in Turkish-American relations, with co-operation on a host of issues: the Arab-Israeli dispute; opening a dialogue between America and Iran to curb Tehran's nuclear programme; stabilising Iraq as American forces leave; and opening energy pipelines through the Caucasus.

Perhaps the most important of these issues is Iran. This week Turkey's President Abdullah Gul, in Tehran for a regional economic summit, met the country's supreme leader, Ayatollah Ali Khamenei. It was the first time the leader of a NATO member state had been given such an audience, said Mr Gul's entourage. Iranian leaders listened as Mr Gul, who recently met the American secretary of state, Hillary Clinton, urged Iran to take up an American olive branch. Mrs Clinton said Iran would be invited to a meeting in The Hague later this month of Afghanistan's neighbours and countries contributing troops to the NATO-led stabilisation mission there.

Still, Turkish officials are holding back their hopes of an early breakthrough between America and Iran. It is hard for "an iceberg to melt overnight", says one. America will probably not want to move until after Iran's presidential elections in June. It fears that a quick thaw would strengthen the hardline Mr Ahmadinejad, who could claim that his policy of nuclear defiance had succeeded in forcing America to deal with Iran on its own terms. Until then, Turkey hopes America will restrain the incoming Israeli government from turning up hostile rhetoric against Iran, or from trying to attack its nuclear facilities.

Iran, for its part, told Turkey it wants more confidence-building steps from Washington. In public, it shows little sign of softening. Mr Ahmadinejad dismissed Turkey's mediation. Mr Khamenei said America had made "big mistakes" in Iraq, Afghanistan and Gaza. "The American government is continuing the same previous path and there is no sign of efforts to make up for the mistakes," he said.

Turkey wants to highlight Mr Erdogan's other moves: helping repair Syria's relations with Saudi Arabia and Egypt, and pushing for reconciliation between the two Palestinian factions, Hamas and Fatah. Turkey also claims to have played a part in bringing together the leaders of Afghanistan and Pakistan. "Obama knows that," says Mr Gul.

As Europe frets about the reliability of oil and gas supplies from Russia—a dispute with Ukraine in January left much of eastern and central Europe freezing—Turkey's position as the alternative route for energy supplies through Georgia should enhance its standing. This fragile corridor would be strengthened if Turkey were to succeed in another ambition: a grand bargain to resolve border disputes involving Turkey,

Armenia and Azerbaijan.

Ruthenia

A glimpse of daylight

Mar 12th 2009
From The Economist print edition

Ruthenia was once independent, for one day. Now Ruthenes are getting restive

FOR connoisseurs of obscurity, the Republic of Carpatho-Ruthenia takes some beating. Seventy years ago, on March 15th, it enjoyed its sole day of independence—declared in the morning amid the Nazis' dismemberment of the then Czechoslovakia, snuffed out in the evening by an invasion from neighbouring Hungary. Its leader, Avhustyn [Augustin] Voloshyn, died in a Soviet jail in 1945; so did many others. Before the world had even noticed its existence, independent Ruthenia disappeared into first the Nazi, then the Soviet empires.

Ruthenians have had little joy since. A list of famous Ruthenes begins and pretty much ends with Andy Warhol: the artist did not himself speak Ruthene, though his parents did. He once said he had "come from nowhere". Many Ruthenian activists feel that way, too.

A million-plus by the most generous count (but far fewer according to sceptics), Ruthenians are scattered through the Carpathian regions of Slovakia, Poland and Ukraine, with another bunch in former Yugoslavia. Some are Orthodox, but most are eastern-rite Catholics. That prompted savage suppression in the communist era.

Many doubt the Ruthene claim to any form of national identity. Even the placename is disputed. Czechs and Slovaks, looking east, tend to talk of "Sub-Carpathia"; Ukrainians, looking west, talk of "Trans-Carpathia". Communist rulers denied Ruthenes existed at all. Ukraine recognised them as an ethnic minority only in 2007. The language—sometimes called Rusyn—is dismissed as a mere dialect of established Slavic tongues, even by some who speak it.

But the Ruthenian cause is stirring. In western Ukraine, Ruthenian revivalists have demanded self-determination. One group has even declared independence. Their self-proclaimed prime minister, Petr Getsko, told a Russian government newspaper in December that the "lion's share" of Russian gas exports to Europe pass through pipelines across Ruthenia.

In Slovakia, self-declared Ruthenians are more numerous, but shun the separatist strivings across the border. Overshadowed by Slovakia's much larger Hungarian and Roma (Gypsy) minorities, they would be happy with just a little more schooling and broadcasting in their fragile language.

Charlemagne

Beware of breaking the single market

Mar 12th 2009
From The Economist print edition

European governments are turning against the European Commission, with mischief in mind

Illustration by Peter Schrank

THE European Commission, say the grumblers of Brussels, is adrift in this economic crisis. Euro-fundamentalists sigh for Jacques Delors, the pugnacious Frenchman who ran the commission—the EU's executive authority—from 1985 to 1995. Amid economic disarray, it is said, the commission should be seizing its chance to set the agenda for Europe.

One can hear similar complaints about an inactive commission from national leaders, notably President Nicolas Sarkozy of France. At a mini-summit earlier this month, he declined to repeat his previously explicit support for giving José Manuel Barroso, the commission's president, a second term. Mr Sarkozy's outburst cheered the anti-Barroso camp in Brussels. Yet in truth, the critics often have contradictory grievances.

The federalist hardcore yearns for the commission to use the crisis to grab power from national governments. Many would like a new, pan-European financial regulator. Others would cheer if the commission moved to harmonise labour and fiscal policies across Europe. That is not an idle threat: if lots of eastern and central European countries need European rescue funds, expect to hear calls for them to be forced to raise tax rates or impose an EU minimum wage.

When leaders say that the commission is being too passive, they actually mean the reverse: they think it is too zealous about enforcing Euro-rules on free competition. They want it to stand aside so interventionist governments can create "European industrial champions" through measured doses of protectionism, privileged access to public contracts or cosy collusion between firms in different bits of Europe. Some new members would like the EU to ease rules on how they may spend regional aid, or those that make joining the single currency slow and difficult. Even key supporters of free competition, like Britain and Ireland, are going wobbly. Senior figures say that as more and more banks need saving, the British and Irish appear more fussed about financial stability than about EU rules on market shares or state aid.

At an EU summit last December, Mr Sarkozy berated the commission for applying its rules too rigidly. All around the table, heads were nodding. If a show of hands had been called, a senior figure now says, an "overwhelming majority" of EU leaders would have voted to suspend the internal market's rules.

Since then, EU leaders have reaffirmed their loyalty to the internal market. But many countries, among

them Germany and France, wish that the market were not so free. Astonishing as it may seem to British critics of Europe, in Brussels the chief complaint is that the dominant ideology of the European Commission, especially in the financial sector, is British-style liberalism. Angela Merkel, the German chancellor, is said to deliver "rants" about the "Anglo-Saxon" system. Many leaders on the continent would love to regulate the City of London down to size, for reasons of both ideology and commercial rivalry.

So Mr Barroso will face a bumpy few months. In June, EU leaders are due to choose the next European Commission president, who would hand out portfolios to commissioners nominated by national governments a few months later. France is determined to claim a big economic portfolio. So are the British, but their stock is low. Mr Sarkozy has thrown the timing into doubt, suggesting that a vote on the commission boss should be delayed. In France, Socialist party leaders say their campaign for June's European Parliament elections will denounce the supposed "Barroso-Sarkozy axis" of wicked "ultraliberalism".

And yet Mr Barroso will not be easy to shift. He has incumbency on his side, and is a member of Europe's largest centre-right political grouping, the European People's Party, which is expected to retain its majority in the European Parliament. Other names are mentioned as rivals, such as François Fillon, the French prime minister; Jan Peter Balkenende, the Dutch prime minister; and Jean-Claude Juncker, the veteran Luxembourg leader. However, all have counts against them. Senior French officials admit to some irritation with Mr Barroso, who stands accused of stubbornly pursuing unpopular causes in the name of free trade—trying to force Europeans to grow genetically modified corn from America, for example. But they insist that France has no rival candidate for his job. Mr Balkenende, for his part, is another broadly Atlanticist free-marketeer. Mr Juncker, a federalist, would risk a British veto, and is not favoured by Mr Sarkozy.

What price President Blair of Europe?

French officials say they want Tony Blair, the former British prime minister, to land a big new job that will be created if the Lisbon treaty is finally ratified this year: that of full-time president of the European Council. That would involve Mr Blair representing Europe's 27 national leaders and chairing their meetings.

Yet in an economic crisis as broad and deep as this one, the horse-trading becomes unpredictable. Could there yet be a bargain in which Britain would allow an economic non-liberal to take over the commission, in exchange for a President Blair of Europe? If so, it is a bargain Britain should resist, even if that means sacrificing Mr Blair. Saving the internal market is the EU's biggest ideological fight for a generation, and the commission is the body that matters most on this.

A British government ditching its own to save the European Commission president? When Europe's free markets are under attack, the strangest alliances can make sense. Similarly, lest they end up encouraging economic nationalism, Europhiles who loathe Mr Barroso should beware of egging on the national leaders carping at the commission. If that spreads, it could sink the whole project, not just leave it adrift.

Charlemagne now writes a blog, which is open for comment at **Economist.com/blogs/charlemagne**

Northern Ireland

Shadow of the past

Mar 12th 2009 | BELFAST
From The Economist print edition

Pacemaker Press

A reminder of the Troubles brings unionists, policemen and republicans together

THREE deaths in two days have left Northern Ireland reeling. On March 7th two young British soldiers—Mark Quinsey and Patrick Azimkar—were caught in a hail of automatic-rifle fire when they stepped outside the Massereene army base to take delivery of a pizza. Forty-eight hours later Stephen Carroll, a police constable with less than two years to go until retirement, was shot in the head when he answered a call for help in Craigavon. Dissident republican terrorists claimed both killings. Is this the dying embers of a waning conflict or a new one flaring up?

The first murders of members of the security forces since 1998 brought thousands out in silent protest rallies across the province. Politicians of all persuasions joined forces to demonstrate their commitment to peace, and to continuing down the path to power-sharing that began with the Good Friday agreement in 1998.

Peter Robinson, leader of the once hardline Democratic Unionist Party and first minister of the province, asserted that this was "a battle of wills between the political class and the evil gunmen" which the political class would win. Martin McGuinness of Sinn Fein, a former IRA leader and now deputy first minister, called the dissidents "traitors to the island of Ireland". At Stormont, they flanked Sir Hugh Orde, the English boss of the Police Service of Northern Ireland (PSNI), as he pledged to leave no stone unturned in bringing his constable's killers to justice.

The importance of such gestures is hard to overestimate. Mr Robinson essentially admitted publicly that former terrorists were now his political allies. Urging unionists angered by the killings to support the "due process of law" was an appeal for restraint to loyalist paramilitaries, who remain armed. When Mr McGuinness, for his part, said that he would give the police information about the killers if he had it, he made himself an even bigger target for dissident republicans who already reviled the mainstream IRA for treating with the enemy. Neither man's remarks might seem exceptional to outsiders, but they are a big advance for a power-sharing administration hobbled by long mistrust.

After two postponements the leaders finally flew on March 11th to America, where they were to meet its president, Barack Obama, and rev up enthusiasm for Northern Ireland at the White House's annual St Patrick's Day shindig. But they left questions in their wake that will not soon be answered. The first is just who these dissident republicans are. The second is how big a threat they pose.

Responsibility for the attacks was claimed by different groups. A phone call to a Dublin newspaper said the soldiers had been killed by the Real IRA, notorious for the Omagh bombing in 1998. Another bid for recognition came hours later in the name of "Oglaigh na hEireann" (ONH), which had also claimed ownership of a 300-pound bomb abandoned in January near army barracks in County Down. The Continuity IRA said it had murdered Mr Carroll: intermittently active for 15 years, the group is known for having organised the odd riot in Craigavon.

What intelligence exists suggests that although four dissident republican groups stand out, their overlapping and often feuding memberships may total no more than a few hundred. The older groups split from the IRA at different times but all accuse Sinn Fein, the IRA's political wing, of selling out by winding down its mainstream armed activities and collaborating with the unionists in government.

Out but not down

Republican dissidents have made many attempts to kill police, particularly Catholic officers who now make up almost a quarter of the force. Around 100 are in jail in Northern Ireland and the Republic, convicted of dissident offences or awaiting trial suspected of them. In November the Independent Monitoring Commission, set up by the British and Irish governments to report on political violence in the province, said the Real and Continuity IRAs, ONH and the INLA (Irish National Liberation Army)—the last now more engrossed in straight criminality—all remained threats. And even in these *jihad*-obsessed days MI5, in charge of Britain's domestic intelligence, spent 15% of its budget in 2007-08 on tracking republican dissidents.

As to what motivates them, a dissident spokesman provided a clue last month in a rare interview with a Belfast paper, the *Irish News.* Politics had failed republicans: "politics and military cannot operate side by side." To avert another Omagh they would not leave bombs in town centres but would target the security forces. Police and mainstream republicans say, and a number of arrests bear them out, that most dissidents are not disaffected ex-IRA but younger men, drawn in by a mixture of diehard belief that violence is essential if Northern Ireland is to be freed from the United Kingdom and a hankering for the excitement of disorder and the community status that paramilitaries once enjoyed.

Are Northern Ireland's police on top of all this? Sir Hugh clearly has his doubts. He repeated recently that the dissidents had become more dangerous than at any time in his seven years in office. The PSNI is smaller and less battle-hardened than the Royal Ulster Constabulary (RUC) it replaced. When Sir Hugh asked for military backup to get better intelligence on the dissidents, the subsequent, undiscussed arrival of undercover surveillance experts from the Special Reconnaissance Regiment provoked a spat with Sinn Fein days before the soldiers in Antrim were killed.

Inviting in the soldiers, said Gerry Adams, Sinn Fein's president, had been a dreadful mistake. It undercut the argument for turning from violence to politics that had been sold to militant republicans: that the army would be reduced (as it has been, from a peak of about 30,000 soldiers to no more than 5,000) and a police service accountable to local politicians would replace the heavily Protestant RUC. Sir Hugh had begun to mollify Sinn Fein by promising to use only a small number of surveillance experts to help keep "dissident republicans under the cosh" when the gunmen found, tragically, the softest of army targets.

Political apathy

Of banks and ballot boxes

Mar 12th 2009
From The Economist print edition

The recession could shed light on voter disenchantment

POLITICAL diaries—usually fat, often turgid, almost always self-justifying—tend to be read only by a few Westminster obsessives. But those of Chris Mullin, a former junior minister in Tony Blair's government, could have a wider appeal. A sense of detached irony pervades Mr Mullin's book: frustrated by the trivial nature of his job, he christens his first department (officially responsible for regional development, the environment and the entire British transport network) the Ministry of Folding Deckchairs. One reviewer describes the book as "an amusing portrait of tedium and widespread ineptitude".

It is a view of political life widely held outside Westminster. Politicians are disliked, distrusted and seen as out of touch. Voting has dropped dramatically: only 61% of Britons could be bothered to do it in the general election of 2005. To some extent, that reflects a general trend in most rich countries—with the notable recent exception of America, where turnout is rising from a lower base. But Britain's decline has been particularly steep and particularly recent, with participation falling off a cliff after 1992 (see chart). On March 12th the Economic and Social Research Council (ESRC) hosted a debate about the cause of disengagement and what might be done to reverse it.

The evidence is hard to disentangle. Many think voting has dropped because trust in politicians is waning. But data from Ipsos-MORI, a pollster, show that the share of voters who think their representatives tell the truth has stayed constant over the past two decades (at 18%).

Others blame the soporific effects of almost 16 years of economic growth. But voting increased during the boom of the mid-1980s. Labour's daunting majorities are also often invoked (although Margaret Thatcher's similarly healthy leads did not seem to discourage voters), as is the death of attention-grabbing ideology.

Colin Hay, a professor at the University of Sheffield and a participant in the ESRC debate, blames a crisis of confidence among politicians themselves. The deliberate delegation of responsibility to supposedly trustworthy technocrats (giving the Bank of England responsibility for setting interest rates, for example) has robbed politicians of much of their power, he says, and thus the public of much of the reason for voting for them.

Happily for psephologists, the credit crunch offers a natural laboratory for testing some of their hypotheses. With unemployment heading towards 10%, output collapsing and public debt rocketing, contentment is likely to be scarce at the next election, which must be held by June 2010. Imploding banks have revived political intervention in an area formerly dominated by unelected regulators. The prospect of a crippling recession is beginning to sharpen ideological distinctions. And bad times do seem to bring people to the ballot box: turnout was high in the recession of the early 90s, in the aftermath of the three-day week in the 1970s and during the years of austerity after the second world war.

Illegal immigrants

All sins forgiven?

Mar 12th 2009
From The Economist print edition

A report on the scale of undocumented working sparks calls for an amnesty

PROTECTED by a 20-mile-wide moat, Britain need not worry as much as most countries about illegal border-hoppers. There are those who take the wet route: a new French film, "Welcome", tells the story of a Kurdish boy's plan to swim *La Manche* to be reunited with his girlfriend in Britain. More common are those who stow aboard lorries to get across by ferry or tunnel. But such plans are fairly easy to foil: border guards have turned away 88,500 Channel-crossers in the past five years.

Nonetheless, it appears that the number of "irregular" migrants in Britain has been growing fast. The government's previous best estimate was that in 2001 there were 430,000 undocumented residents, made up of illegal entrants, visa overstayers, failed asylum-seekers and the British-born children of all the above. But on March 9th a report commissioned by Boris Johnson, the Conservative mayor of London, suggested that the figure is now nearer 725,000. The authors, from the London School of Economics (LSE), reckon people whose asylum claims have been rejected but who have not returned home account for most of the growth.

The number is still small by international standards: America, for instance, is thought to harbour some 12m undocumented workers, more than three times as many as Britain has per head. But the LSE team points out that Britain's irregular residents are unusually highly concentrated in London. Around two-thirds are based in the capital, they estimate, which means that roughly one in 15 Londoners is living there illegally.

That is a tax base worth taking seriously. Against his own party's line, Mr Johnson backs a managed amnesty for those workers, which would bring about 320,000 Londoners in from the cold if it were offered to those who had been in the country for at least five years, as is mooted. The power to grant such an amnesty lies with the central government, whose view is that it would merely encourage more people to try their luck in future. But the Liberal Democrats are in favour and so are many Labour MPs, including Harriet Harman, who, many reckon, is already running to be the Labour Party's next leader.

For some, the moral arguments weigh most heavily. Jeff, a failed asylum-seeker from Zimbabwe, describes nine years in Britain being bounced from one agency to another, unable to work and afraid to return home. His children did well at school but cannot go to university; they too now live lives of enforced idleness. "It mirrors what is happening to so many families," he says. Fear of deportation keeps sick children away from hospital and battered prostitutes away from the police, and promotes other woes.

The LSE will deliver a second report in May, weighing the costs and benefits to the taxpayer of an amnesty. Given the difficulty of comparing the pros and cons of even legal migration, assessing the undocumented will be impressionistic at best. But the "vast majority" of irregulars are "young, single men who use services very lightly", the researchers say, suggesting that any additional burden on public services would be slight. And some are laid on already: health care, for instance, is provided at the discretion of doctors, few of whom are sticklers for the correct papers.

Perhaps more controversial would be the impact on the job market of hundreds of thousands of newly legal workers. But that, too, is hard to predict. Undocumented workers are the most competitive of all, because employers don't need to worry about sick pay, holidays or the minimum wage. Giving them the same legal rights as everyone else might actually raise wages in sectors such as construction, agriculture and hospitality.

Amnesties for those who have broken the rules are never popular. But they are not unusual. France, Greece, Italy, Portugal and Spain have regularised more than 3m illegal residents in the past 20 years. And Britain has done it too, albeit modestly. Between 1998 and 1999, domestic workers who had broken their visa restrictions were offered the chance to come clean without penalty. And in 2003 the Home Office announced an amnesty for 15,000 asylum-seeking families who had been the victim of an unusually long

backlog in processing applications. That scheme was portrayed as a measure to “clear the decks” before introducing new, tougher immigration controls. As the government prepares to roll out its new ID-card scheme, could this be the moment for an amnesty?

Condoning torture

Shoulder to shoulder

Mar 12th 2009
From The Economist print edition

Britain's role in America's alleged torture programme is looking murky

WITH a thinner body and fuller beard, Binyam Mohamed stepped off a plane onto British soil for the first time in nearly eight years last month. He brought back stories, published in a newspaper interview on March 8th, of his detention in Pakistan, Morocco, Afghanistan and, from 2004, Guantánamo Bay. He claimed that, as a Moroccan torturer set about his penis with a razor blade, he was asked questions supplied by MI5, Britain's domestic intelligence service. Initially arrested after travelling to Afghanistan on a false passport, Mr Mohamed is not everyone's idea of a reliable witness. But claims about Britain's role in his mistreatment, and that of others, are looking increasingly plausible.

The day after the interview, Martin Scheinin, a UN special rapporteur on human rights, published an analysis of the abuses that have taken place around the world in the name of fighting terrorism. Few countries got off lightly: France, Germany and Italy are among those who, like Britain, sent interrogators to Guantánamo despite calling for its closure. But Mr Scheinin fingered Britain as America's chief cheerleader. Along with America and Australia, British personnel have interviewed captives held incommunicado by Pakistani intelligence "in so-called safe houses, where they were being tortured". Even if they did not witness torture, their presence "can be reasonably understood as implicitly condoning such practices", he wrote.

AP

Binyam Mohamed manhandled

As for extraordinary rendition—transferring people without legal formalities to countries that practise torture, or to secret CIA prisons—Britain was the only western European country to be named as one that "facilitated" renditions. There are "consistent, credible reports" that British personnel have "provided intelligence or have conducted the initial seizure of an individual" for extraordinary rendition, Mr Scheinin reported. In response, the Foreign Office could only repeat its condemnation of both extraordinary rendition and, indeed, torture.

Mr Mohamed's case, and the allegation that MI5 was complicit in his torture, has been under investigation by Lady Scotland, the attorney-general, since October. Opposition politicians accuse her of bias—she is a Crown appointee—and foot-dragging, and have demanded a judge-led inquiry. If that is granted, more secrets may well emerge.

Last year David Miliband, the foreign secretary, apologised after it emerged that two American rendition flights had stopped on Diego Garcia, a British territory—an idea the government had previously dismissed as nothing more than "conspiracy theories". Last month John Hutton, the defence secretary, acknowledged that British special forces had captured two Pakistanis in Iraq and handed them over to American custody, after which they were transported to Afghanistan in contravention of an agreement with Britain. Earlier, the government had denied that too. What skeletons will fall out of the closet next?

Public-services reform

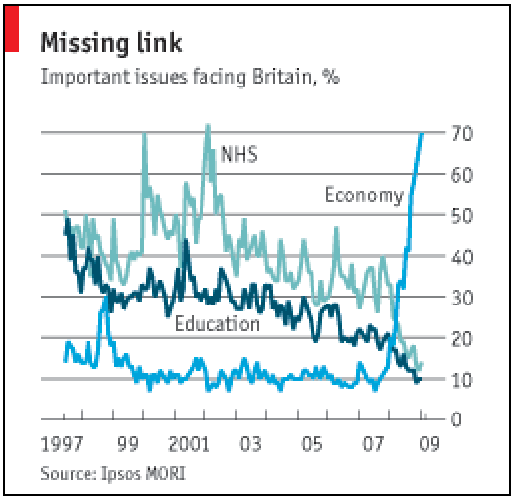
Preparing for austerity

Mar 12th 2009
From The Economist print edition

Offering more of the same won't work if there's less money to pay for it

GORDON BROWN may seem to do little else these days than strive to save the economy (and the world), but Labour spent its first decade in power trying to rescue the public services. On March 10th the prime minister returned to that theme with a newish-sounding idea: handing over more information, and thus power, to the users of these services. He proffered a vision in which patients choosing a family doctor or parents looking for child care could benefit from the same kinds of reviews and ratings that are now available for books and other products on internet sites like Amazon.

Yet just as Mr Brown has become preoccupied by the economy, so too has the public (see chart). Anxieties about health and education have fallen markedly while economic worries have vaulted. Despite all the prime minister's efforts to blunt the recession, most people are giving him no credit and Labour is well behind the Conservatives in the polls. The prime minister's hope is that by the time of the next election, due no later than June 2010, people will be paying more attention to public services again, traditionally a strong point for Labour, and listening not just to what it has done but also to what it can offer.



Mr Brown's emphasis on empowering the users of public services through information is rather different from that of Tony Blair. The former prime minister came to endorse the view that greater choice and competition were essential to improve the public services. Mr Brown may invoke the idea of choice, but there is no longer the same drive from Number 10 to open up the public services to the invigorating winds of competition.

That makes Mr Brown's analogy with reviews on Amazon and the like beside the point. Voice and choice make a potent partnership where informed consumers can choose between different suppliers. Voice without genuine choice, by contrast, is a feeble thing, offering little more than echo chambers for frustrated complaints by users facing monopoly public providers. This is true whether they are commuters on London's Tube or parents trying to get their children into a half-decent state school.

The prime minister's tame big idea for the public services—set out in a policy paper called "Working Together"—was the more disappointing because he made an important point in acknowledging that the financial crisis called for a fundamental reappraisal of the role of the state. What Mr Brown pretentiously called Labour's "settlement of 1997"—its efforts to bridge the gap between the state and the markets through public-private partnerships—was "inadequate" because markets themselves needed more supervision. But he studiously ignored the elephant in the room: the damage dealt to the public finances by the recession and the banking bail-out, exacerbated by his persistent budget deficits in the good years gone by.

The likely hit was set out on March 6th in some gloomy figures from the International Monetary Fund in the run-up to the G20 summit Mr Brown is hosting in London on April 2nd. The IMF estimates that government debt will shoot up in Britain from 44% of GDP in 2007 to 69% in 2010. This increase of 25 percentage points will be bigger than that for most of the advanced G20 economies and compares with a rise of 17 percentage points predicted by the Treasury last November. And if the recession proves more severe and the recovery more anaemic than expected, the eventual outcome could be even worse.

What this heralds is a clampdown on government spending that will reshape the public services far more fundamentally than the prime minister's innocuous reform. So much money has been thrown at them for so long without a commensurate improvement in what they do that a squeeze is overdue. A report from

PWC, an accountancy firm, on March 10th suggested that a freeze on spending in real terms for the three years to 2013-14, together with big tax increases, would be necessary, and came up with ideas for making the public sector more efficient.

Mr Brown's musings on the role of the state failed to tackle the crucial issue of how health, education and the like will cope with austerity. But nor have the Conservatives worked out what to do with them, let alone how much they should confide in the public about the hard times that lie ahead. One thing is certain: whoever wins the next election will dish out far harsher treatment to the public services than inviting comments on the web.

Harriet Harman

Lady in red

Mar 12th 2009
From The Economist print edition

Gordon Brown's deputy is the early favourite to replace him

PRIVILEGE is no bar to the commanding heights of the Labour Party. Neither are women always squashed under its industrial machismo. There is even a place for lifelong Londoners in a movement whose heartlands are northern and Celtic. So much is obvious from a glance at the cabinet, with its expensively-schooled chancellor, female home secretary and Primrose Hill's own Miliband brothers.

But no modern Labour figure embodies all three forms of otherness like Harriet Harman, the deputy leader whom many suspect of manoeuvring to replace Gordon Brown after the general election he seems doomed to lose next year. Recent weeks have seen this feminist of vaguely aristocratic provenance, not only a native of the capital but an MP for one of its constituencies, side with the left of the party on such wedge issues as bankers' pay and the planned part-privatisation of the Post Office. Bookmakers have her the favourite to take over from Mr Brown and, having beaten five others to the deputy leadership in 2007, she is a proven winner.

PA

The bookies' favourite

She is also a survivor. Almost half of her 58 years have been spent in Parliament. She has weathered myriad setbacks, including her controversial decision to send her son to a selective school, and her sacking in 1998 as secretary of state for social security after a row with a junior minister there. And unlike other veterans such as Jack Straw and Alistair Darling, she projects a hint of freshness: her three years out of government (followed by four in the quiet role of solicitor-general, where she relived her early career as a lawyer) proved as invigorating as it was frustrating.

Even Ms Harman may be daunted, though, by the obstacles that lie between her and the Labour crown. Younger colleagues such as James Purnell, Ed Balls and one or both of Ed and David Miliband can claim to be better long-term bets. The Labour left, in which the party may seek comfort after years of centrist compromise, is roamed by the creative Jon Cruddas and the increasingly active Peter Hain, both outside the cabinet. Ms Harman is no great thinker, say many, and lacks political judgment. Such carping is unfair—she has not survived for so long through obstinacy alone—but she recently encouraged it with a bizarre and unenforceable promise to deny a failed banker his hefty pension.

Ms Harman also personifies a rather narrow sect of Labour thought. Unkindly nicknamed "Hattie Harperson" for her political correctness, she has often championed a cultural rather than economic leftism associated with the bolshier London boroughs in the 1980s. The Equality Bill she is shepherding through Parliament, with its new rights for women and minorities, is a kind of manifesto for Harmanism. Critics of her preoccupation with sexism often make her point for her with their ugly tone ("treachery in high heels" was one columnist's verdict). They also underestimate the role her harsh and lonely introduction to Parliament—where, heavily pregnant, she joined just nine other Labour women in 1982—played in shaping her views.

But cultural politics of this sort does not animate many of her party's bedrock members, for whom Labour is just what its name implies: a movement for the economic betterment of working people. Ms Harman got little support from the unions in the deputy-leadership race, despite being married to an important trade unionist. And that was before the recession made the culture wars seem kitsch. Yet Ms Harman cannot express her thoughts on economic matters without provoking charges of sharp-elbowed self-promotion. A YouGov/Compass poll of Labour members conducted in February showed her job performance rated below that of Alistair Darling and David Miliband, despite their mixed records as chancellor and foreign secretary respectively, and worse than that of the embattled Mr Brown. It may be a

perception of disloyalty that is denting her popularity in this most tribal of parties.

The unforced errors that have given rise to this image can be ironed out. But the apparent disadvantages Ms Harman can do nothing about—her gender, privilege and metropolitanism—may come to be seen as electoral assets in a party that, lest it forget, won power by adding middle-class women and southerners to its core vote.

State-owned banking

Good sport

Mar 12th 2009
From The Economist print edition

Banks are getting by; a pity about the customers

Illustration by David Simonds

WHY the air of jollity at this branch of the Halifax, a bank in London's West End? Perhaps it is the surprising flood of savings from architects, lawyers and other businesses still coming through the door. Perhaps it is relief that Lloyds Banking Group (LBG), formed when Lloyds TSB took over Halifax Bank of Scotland (HBOS) in January, has at last agreed to the government taking a majority stake in the business, in exchange for insuring worst-case losses on £260 billion of its dodgy assets. Or perhaps the staff are just happy they still have jobs. Before its rescue last September HBOS was close to collapse, and it recorded a loss of £10.8 billion for 2008.

Something is missing, however: a sense of urgency about getting the economy's wheels turning again. HBOS has so far failed to get government-guaranteed funds flowing to small businesses. The Enterprise-Finance Guarantee (EFG) scheme, in which the government guarantees 75% of a bank loan to businesses with up to £25m in turnover, was launched on January 14th. Royal Bank of Scotland (RBS), another bank the state owns most of, has already lent £39m under the scheme. Barclays, still in private hands, says it is making EFG loans totalling about £1m a day. HBOS took until the first week of March to straighten out its documentation, and on March 11th its call centre in Edinburgh had still not got the message to start selling.

HBOS protests that it was quicker off the mark with another government scheme, using funds from the European Investment Bank to lend to small companies. But the discrepancy among these banks shows how little leverage the state has over bank behaviour, even though it owns big chunks of four of them.

David Sayer at KPMG, an accounting firm, believes this will change as the government figures out how to exercise moral suasion over the banks it owns and even those it does not. When they are given objectives other than just creating shareholder value, bank executives will find it hard to make decisions, he says. The state cannot just issue instructions; it must replace perverse incentives with ones that will make banks want to follow its lead.

Take Northern Rock, a mortgage lender nationalised in February 2008. It spent the rest of that year running down its loan books and pushing customers off to other banks. One reason was that staff bonuses depended on repaying as much of the £27 billion government bail-out loan as possible. Then in February 2009 it announced a return to mortgage lending. It is now pondering new ways of motivating its staff.

Other incentives are affecting banks' behaviour too. Because its deposits are fully guaranteed, Northern Rock has an advantage over other banks. That is why it is required to limit its quest for deposits to 1.5% of the market and offers savings rates lower than the three most competitive.

No such limit applies to RBS and LBG, which still have some private shareholders and could theoretically go bust. The potential for market distortion if these two were fully nationalised is huge: LBG alone accounts for 18% of deposits and 28% of mortgages. So it may be just as well that their rates for most loans, deposits and savings are by no means the best value for customers. RBS, for example, charges a royal 29.8% for unauthorised overdrafts. Halifax levies an apparently innocuous charge of £1 a day for overdrafts up to £2,500. Customers may not realise that the annual charge for being £250 in the red totals 146% of the principal, says Lucy Widenka at Which?, a consumer lobby group. RBS and LBG led the field in reducing their standard variable lending rates in line with Bank of England cuts, but they have not trimmed personal loan rates, which remain at over 12%.

All this is especially disheartening to the small companies for which the government has tried to secure cheaper money, according to a poll by the Federation of Small Businesses. Only 36% of them have heard of the guarantee scheme; 15% fear they will be forced to close down; and 25% would like to see a source of government finance which excludes banks.

The global crisis and the poor

The toxins trickle downward

Mar 12th 2009 | DAR-ES-SALAAM
From The Economist print edition

AFP

A downturn that began in the rich world is hurting those who can least afford it

"POOR countries are innocent," says Ngozi Okonjo-Iweala, the Nigerian managing director of the World Bank. They did not contribute one jot to the global credit crunch, and their banks and firms have few links to global capital markets. For a while, it seemed as if the rich world's mess might even pass them by. The oil-price fall of 2008 benefited oil-importing developing countries to the tune of 2% of their national incomes. As recently as January, the IMF thought emerging and developing countries would grow 3.3% this year, compared with a predicted fall of 2% for rich economies.

But innocence, it seems, will not protect anyone. A financial crisis that began in New York and London and spread to manufacturing in rich, then industrialising countries, has now hit the "bottom billion": the poorest people in 60-odd countries who have seen only halting gains from globalisation, but will feel its reverse, perhaps precipitously.

Many live in sub-Saharan Africa, where the IMF has just cut its forecast for growth this year to 3.3% from an original 6.7%. The figure may fall further. Dominique Strauss-Kahn, the IMF's managing director, told a conference in Tanzania that millions could be thrown back into poverty by the crisis. Piling on gloom, he saw a "threat of civil unrest, perhaps even of war" as a result.

The poor are being hit not by the financial tsunami itself but by second-order waves of trouble. So the impact has been delayed—but it may also be prolonged.

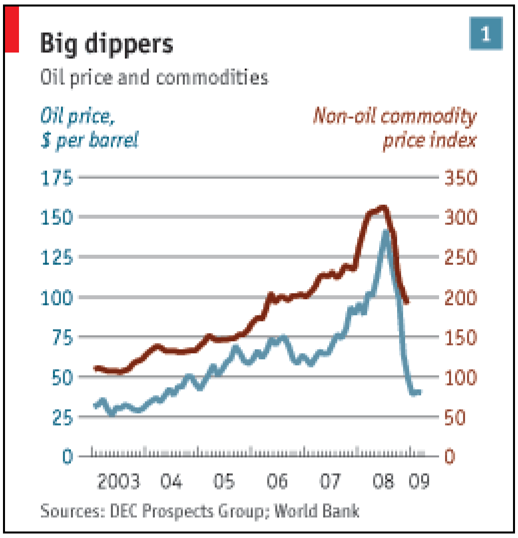
The global meltdown affects poor countries in three ways. First, capital: as investors in the West rebuild balance sheets, private capital flows dry up, hurting marginal borrowers like the poor. According to the Institute of International Finance, a think-tank in Washington, DC, net private capital flows to poor countries will slump from almost $1 trillion in 2007 to $165 billion in 2009. The main victims are big emerging markets in East Asia and eastern Europe. But African countries have been turning to private capital too. In 2007 they raised $6.5 billion in international bonds, trivial in global terms but not to Africa. In 2008, they raised nothing.

For the poor, the other kind of external capital is aid. Britain's Overseas Development Institute reckons that official aid may fall by about a fifth, or $20 billion, this year, after being more or less flat in 2005-07.

The fall is partly a product of the recession in donor countries (some give a certain share of their GDP as aid) and partly a result of currency changes which make aid in pounds and euros worth less in local terms. Italy and Ireland are cutting their aid effort. Others are "front-loading" it (borrowing from future years to keep steady now), so aid could fall further after 2009.

As capital flows dry up, investment is being slashed. ArcelorMittal has mothballed an iron-ore project in Liberia. Malawi is losing a uranium project that the government had hoped would account for a tenth of national income. The World Bank estimates that new private activity in infrastructure was 40% lower in August-November of 2008 than a year before.

The second effect of the meltdown is the dive in commodity prices (see chart 1). Most poor states still rely on commodities for big shares of their foreign exchange and tax revenues. Cocoa generates a fifth of Côte d'Ivoire's revenues, for instance.

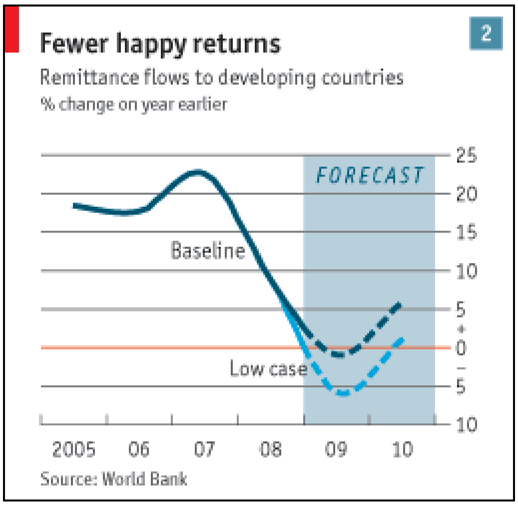


For such places, price volatility has been a curse. The drop in oil and commodity prices in 2008 benefited oil- and food-importers. But this followed a sharp price rise and, for many, relief has come too late. The food crisis of 2007-08 increased the number of people suffering from malnutrition by 44m. Farmers and oil exporters benefited then. No longer.

Now, falling export earnings are exacerbating poor countries' woes. In theory, the poorest should be cushioned from declining world trade. Even so, the latest data look dire. American imports from middle-income countries fell 3% in the year to November 2008. But imports from poor countries fell 6%; those from sub-Saharan Africa, 12%. The African Development Bank says African current accounts, in surplus by 3.8% of GDP in 2007, will be 6% in the red this year.

The fall in commodity prices puts further pressure on budgets, already hit by declining aid (which can substitute for taxes). African budgets have swung from a healthy surplus of 3% of GDP in 2007 to a forecast deficit of the same amount in 2009. This leaves no room for economic stimulus. On one estimate, only one-quarter of vulnerable countries have any scope to raise their budget deficits and boost spending—in contrast with the West.

The third area where the meltdown is being felt is labour. Those poor countries that do make things for export are suffering from the fall in world trade. India lost 500,000 export jobs in the last quarter of 2008, for example. Many countries also export workers who send back remittances. These were worth $300 billion in 2008, more than aid. Some countries depend on them. They account for 45% of GDP in Tajikistan, 38% in Moldova and 24% in Lebanon and Guyana. Remittances had been rising fast in 2005-07; now they are falling (see chart 2). Malaysia recently revoked work visas for 55,000 Bangladeshis in order to boost job prospects for locals. Countries which send workers to Russia are doubly hit: many work in the crisis-affected oil industry and send money back in fast-depreciating roubles.



The overall picture is dire. As capital inflows and export earnings vanish, poor countries face a mountain of debt: $2.5 trillion-3 trillion of emerging-market debt falls due in 2009—as much as the American and European budget deficits, plus Europe's bank bail-out costs. The World Bank puts emerging markets' financing shortfall between $270 billion and $700 billion.

Tragically, these problems follow a decade of growth that has lifted millions out of poverty. According to Martin Ravallion of the World Bank, roughly one person in six in emerging markets had raised themselves above the $2-a-day poverty line in 2005, though they still got less than $3 a day. Many may now slip back. Mr Ravallion thinks that 65m people will fall below the $2-a-day poverty line this year, 12m more than he had expected a month ago; 53m will fall below the level of absolute poverty, which is $1.25 a day—compared with 46m expected last month.

The consequence will be dreadful. The World Bank reckons that between 200,000 and 400,000 more children will die every year between now and 2015 than would have perished without the crisis. Progress towards a richer, more equitable world has been set back years.

Economist.com WORLD INTERNATIONAL

Banks, graft and development

Dancing with despots

Mar 12th 2009
From The Economist print edition

When bankers are pimps

DESPITE all the aid, investment and remittances that flow from richer economies to poorer ones, too much capital sloshes right back. That is one big reason why parts of Africa and Central Asia, for example, remain chronically poor, even—indeed, especially—where abundant natural resources could in theory be used to finance roads, schools and local enterprise.

If capital often flees poor countries, that is not only because higher, or more secure, returns might be obtained elsewhere. Too frequently it is shovelled abroad by political leaders who have tapped treasuries, pocketed aid money and collected bribes. The double whammy of graft in the poorest countries is that state funds are first diverted into private hands and then sent overseas. By contrast, in much of Asia, also blighted by graft, leaders more often keep ill-gotten gains in local accounts.

AFP

Nguema: a president on a pedestal

Who is to blame for such looting? A new report* by Global Witness, a group that studies links between resource exploitation and war, accuses several prominent Western banks of helping it. The activists cite links with the leaders of five west African countries and with a late president-for-life in Turkmenistan. By taking dictators' cash, the banking system is "complicit" in perpetuating misrule and poverty, claim the authors. Separately, Paul Collier, an economist with a populist turn of phrase, calls such banks "pimps". If they rejected stolen money, says the report, ordinary people would benefit "in a way that aid flows will never achieve".

The authors note some striking cases of financiers colluding with tyrants. In 2001 Britain's banking regulator found that 23 banks in London had handled $1.3 billion of some $3 billion-5 billion looted by Sani Abacha, a Nigerian despot. Five years ago a venerable American institution, Riggs Bank (where Abe Lincoln once banked), collapsed after a Senate inquiry revealed that Augusto Pinochet of Chile and Obiang Nguema, the long-serving president of Equatorial Guinea, had stashed millions in private accounts, with no proper questions asked. Mr Nguema admitted he had put state funds in a private account, but said he did so to keep it "safe" from thieves.

Barclays, which was shown by the report to be doing business with members of Mr Nguema's family, told Global Witness that it was not prepared to discuss its dealings with individual clients; the bank added, however, that it always takes care to follow "globally applicable anti-money laundering policies".

The activists are not claiming that banks who deal with despots are breaking laws, but they want more effort to check where clients have obtained their cash, and tougher regulation of dealings between banks and "politically exposed persons"—in other words, government officials, their relatives and associates. Banks have proved capable, in some degree, of stanching the flow of funds linked to terrorism, money-laundering or tax evasion. More regulation might possibly deter them from handling the proceeds of misrule.

*"Undue Diligence: How banks do business with corrupt regimes". Global Witness; March 11th 2009

Economist.com WORLD INTERNATIONAL

Russia and America

And now for a nuclear remake

Mar 12th 2009
From The Economist print edition

A whiff of "superpower" diplomacy as arms control again tops the agenda

THE world no longer holds its breath when the leaders of America and Russia meet to talk. But there will be something of the feel of an old newsreel when America's new president, Barack Obama, meets his Russian counterpart, Dmitri Medvedev, early next month at the G20 summit in London and the follow-on 60th anniversary bash for NATO being hosted by Germany and France. That is because, 20 years after the cold war ended, hopes of deeper cuts in Russian and American long-range nuclear weapons are back at the heart of efforts to stabilise a difficult and hitherto deteriorating relationship.

Both sides are signalling a truce. They have fallen out badly in recent years. Russia disliked NATO's eastward expansion and the Bush administration's plans for new missile defences in Europe. America has fretted over Russia's manipulation of gas supplies to pressure Ukraine and other neighbours, and its August war with Georgia, and unilateral recognition of two secessionist bits of Georgian territory. Russia has also dug in its heels at the UN Security Council, so as to limit sanctions on Iran.

Earlier this month America's secretary of state, Hillary Clinton, told the Russian foreign minister, Sergei Lavrov, that America and its allies would never recognise the Georgian enclaves, or Russia's claims to a sphere of influence over "unwilling nations". But she did agree to a restoration of NATO-Russia ties, suspended since the Georgia conflict. A recent letter from Mr Obama to Mr Medvedev reportedly pointed out that, if the Iranian nuclear threat failed to materialise, there would be less need for new missile defences in Europe.

Linking the unlinkable?

Russia publicly rejects such linkage. However it appears to have withdrawn a threat made by Mr Medvedev in November to put nuclear-capable missiles in Kaliningrad to target the Poles and Czechs. There are reports too that, at least for now, a brake has been put on the sale of Russia's longer-range and more capable S300 anti-aircraft missiles to Iran; it had already sold Iran a shorter-range system.

Could it be an omen, though, that the chirpy Clinton-Lavrov double-act intended to symbolise this new talkativeness—pressing the "reset button" in America-Russia relations for the cameras (see picture)—got partly lost in translation? Mistakenly the Americans labelled the button in Russian not reset but "overload". That might better describe the difficulties in repairing relations, not least in arms control.

AP

Just press this button, and…

Russia would like America to ratify the Comprehensive Test-Ban Treaty; Mr Obama seems willing to make the case, but it is for Congress, which blocked the CTBT first time round in 1999 in a highly partisan vote, to decide. America and its NATO allies want Russia to end its "suspension" of the treaty governing numbers of troops and equipment and their movements in Europe, and to stick to a 1987 treaty that it has been talking of scrapping which bans both America and Russia from even producing, let alone fielding, any intermediate-range nuclear missiles. Russian officials worry that China is still free to deploy these sorts of missiles near Russia's borders, but NATO worries that any that Russia built in retaliation could just as easily pose a new threat to Europe.

Some conciliatory moves have already been made. Both America and Russia have declared a readiness to conclude a new legally binding treaty to replace their 1991 strategic arms reduction treaty (called START-1) which expires in December. A replacement is vital, since the

2002 Moscow treaty, signed by George Bush and Vladimir Putin and cutting operationally deployed warheads on each side to no more than 1,700-2,200 (down from START-1's 6,000 apiece) by 2012, relies entirely on the earlier treaty's rules for verification.

Both agree that these START-1 rules are now too costly and complex and can be simplified. They are also both ready for deeper weapons cuts. Russia fears that without an agreement that would cut America's stockpile too, its own slow and mishap-prone efforts to modernise its ageing fleet of long-range missiles will soon leave it at a clear numerical disadvantage. Meanwhile, further arms cuts, both hope, might smooth the path to agreement on boosting the battered Nuclear Non-Proliferation Treaty at its five-yearly review in 2010; the last one ended badly after a diplomatic punch-up between nuclear haves and have-nots over whether disarmament or curbing the proliferation activities of Iran and others should be the priority.

So might an early and radical chop in weapons numbers be announced by the two presidents next month? Mr Obama has already set "getting to zero" as the guiding principle of his nuclear policy, to loud applause from would-be disarmers. Some have speculated that he could go for an eye-catching first cut to 1,000 warheads each, with more to come. But that could be dangerously over-ambitious.

The lower the numbers go, the trickier the problems get. Imagine cutting to, say, 1,500 on each side and imposing stricter counting rules to meet Russian concerns that America could otherwise still rebuild its arsenal a lot faster, if it so chose: that would require a lot more transparency from Russia's defence ministry and arms factories than they have ever accepted.

Meanwhile the Bush administration had started putting conventional warheads on some of America's fast-flying strategic missiles, so as to strike quickly at important terrorist or other targets. Russia will demand tighter curbs on delivery systems, not just new rules for counting warheads; it will also want any missiles dedicated to "prompt global strike" to be counted in the nuclear tally, since they could be switched back to nuclear use.

Go to 1,000 and America at least would have to consider abandoning one leg of its strategic triad of land-based missiles, nuclear-armed submarines and strategic bombers. That is something not best done by presidential fiat, but only after careful consideration. Awkwardly America's next nuclear posture review won't be ready until the end of this year; talks on a START-1 replacement cannot take their cue from that.

In any case, at such low numbers, the smaller arsenals of China, France and Britain (not to mention India, Pakistan and Israel) loom a lot larger. So does the problem of missile defences, and not just in Europe.

Neither side wants to return to a time where Russia measured its GDP in the hours it could keep America at the nuclear negotiating table. But even with the best will, nailing down a new nuclear treaty by year's end will be tough going.

Global heroes

Mar 12th 2009
From The Economist print edition

Despite the downturn, entrepreneurs are enjoying a renaissance the world over, says Adrian Wooldridge (interviewed here)

Illustration by Nick Dewar

IN DECEMBER last year, three weeks after the terrorist attacks in Mumbai and in the midst of the worst global recession since the 1930s, 1,700 bright-eyed Indians gathered in a hotel in Bangalore for a conference on entrepreneurship. They mobbed business heroes such as Azim Premji, who transformed Wipro from a vegetable-oil company into a software giant, and Nandan Nilekani, one of the founders of Infosys, another software giant. They also engaged in a frenzy of networking. The conference was so popular that the organisers had to erect a huge tent to take the overflow. The aspiring entrepreneurs did not just want to strike it rich; they wanted to play their part in forging a new India. Speaker after speaker praised entrepreneurship as a powerful force for doing good as well as doing well.

Back in 1942 Joseph Schumpeter gave warning that the bureaucratisation of capitalism was killing the spirit of entrepreneurship. Instead of risking the turmoil of "creative destruction", Keynesian economists, working hand in glove with big business and big government, claimed to be able to provide orderly prosperity. But perspectives have changed in the intervening decades, and Schumpeter's entrepreneurs are once again roaming the globe.

Since the Reagan-Thatcher revolution of the 1980s, governments of almost every ideological stripe have embraced entrepreneurship. The European Union, the United Nations and the World Bank have also become evangelists. Indeed, the trend is now so well established that it has become the object of satire. Listen to me, says the leading character in one of the best novels of 2008, Aravind Adiga's "The White Tiger", and "you will know everything there is to know about how entrepreneurship is born, nurtured, and developed in this, the glorious 21st century of man."

This special report will argue that the entrepreneurial idea has gone mainstream, supported by political leaders on the left as well as on the right, championed by powerful pressure groups, reinforced by a growing infrastructure of universities and venture capitalists and embodied by wildly popular business heroes such as Oprah Winfrey, Richard Branson and India's software kings. The report will also contend that entrepreneurialism needs to be rethought: in almost all instances it involves not creative destruction but creative creation.

The world's greatest producer of entrepreneurs continues to be America. The lights may have gone out

on Wall Street, but Silicon Valley continues to burn bright. High-flyers from around the world still flock to America's universities and clamour to work for Google and Microsoft. And many of them then return home and spread the gospel.

The company that arranged the oversubscribed conference in Bangalore, The Indus Entrepreneurs (TiE), is an example of America's pervasive influence abroad. TiE was founded in Silicon Valley in 1992 by a group of Indian transplants who wanted to promote entrepreneurship through mentoring, networking and education. Today the network has 12,000 members and operates in 53 cities in 12 countries, but it continues to be anchored in the Valley. Two of the leading lights at the meeting, Gururaj Deshpande and Suren Dutia, live, respectively, in Massachusetts and California. The star speaker, Wipro's Mr Premji, was educated at Stanford; one of the most popular gurus, Raj Jaswa, is the president of TiE's Silicon Valley chapter.

The globalisation of entrepreneurship is raising the competitive stakes for everyone, particularly in the rich world. Entrepreneurs can now come from almost anywhere, including once-closed economies such as India and China. And many of them can reach global markets from the day they open their doors, thanks to the falling cost of communications.

For most people the term "entrepreneur" simply means anybody who starts a business, be it a corner shop or a high-tech start up. This special report will use the word in a narrower sense to mean somebody who offers an innovative solution to a (frequently unrecognised) problem. The defining characteristic of entrepreneurship, then, is not the size of the company but the act of innovation.

A disproportionate number of entrepreneurial companies are, indeed, small start-ups. The best way to break into a business is to offer new products or processes. But by no means all start-ups are innovative: most new corner shops do much the same as old corner shops. And not all entrepreneurial companies are either new or small. Google is constantly innovating despite being, in Silicon Valley terms, something of a long-beard.

This narrower definition of entrepreneurship has an impressive intellectual pedigree going right back to Schumpeter. Peter Drucker, a distinguished management guru, defined the entrepreneur as somebody who "upsets and disorganises". "Entrepreneurs innovate," he said. "Innovation is the specific instrument of entrepreneurship." William Baumol, one of the leading economists in this field, describes the entrepreneur as "the bold and imaginative deviator from established business patterns and practices". Howard Stevenson, the man who did more than anybody else to champion the study of entrepreneurship at the Harvard Business School, defined entrepreneurship as "the pursuit of opportunity beyond the resources you currently control". The Ewing Marion Kauffman Foundation, arguably the world's leading think-tank on entrepreneurship, makes a fundamental distinction between "replicative" and "innovative" entrepreneurship.

Five myths

Innovative entrepreneurs are not only more interesting than the replicative sort, they also carry more economic weight because they generate many more jobs. A small number of innovative start-ups account for a disproportionately large number of new jobs. But entrepreneurs can be found anywhere, not just in small businesses. There are plenty of misconceptions about entrepreneurship, five of which are particularly persistent. The first is that entrepreneurs are "orphans and outcasts", to borrow the phrase of George Gilder, an American intellectual: lonely Atlases battling a hostile world or anti-social geeks inventing world-changing gizmos in their garrets. In fact, entrepreneurship, like all business, is a social activity. Entrepreneurs may be more independent than the usual suits who merely follow the rules, but they almost always need business partners and social networks to succeed.

The history of high-tech start-ups reads like a roll-call of business partnerships: Steve Jobs and Steve Wozniak (Apple), Bill Gates and Paul Allen (Microsoft), Sergey Brin and Larry Page (Google), Mark Zuckerberg, Dustin Moskovitz and Chris Hughes (Facebook). Ben and Jerry's was formed when two childhood friends, Ben Cohen and Jerry Greenfield, got together to start an ice-cream business (they wanted to go into the bagel business but could not raise the cash). Richard Branson (Virgin) relied heavily on his cousin, Simon Draper, as well as other partners. Ramana Nanda, of Harvard Business School (HBS), and Jesper Sorensen, of Stanford Business School, have demonstrated that rates of entrepreneurship are significantly higher in organisations where a large number of employees are former entrepreneurs.

Entrepreneurship also flourishes in clusters. A third of American venture capital flows into two places, Silicon Valley and Boston, and two-thirds into just six places, New York, Los Angeles, San Diego and Austin as well as the Valley and Boston. This is partly because entrepreneurship in such places is a way of life—coffee houses in Silicon Valley are full of young people loudly talking about their business plans—and partly because the infrastructure is already in place, which radically reduces the cost of starting a business.

Illustration by Nick Dewar

The second myth is that most entrepreneurs are just out of short trousers. Some of today's most celebrated figures were indeed astonishingly young when they got going: Bill Gates, Steve Jobs and Michael Dell all dropped out of college to start their businesses, and the founders of Google and Facebook were still students when they launched theirs. Ben Casnocha started his first company when he was 12, was named entrepreneur of the year by *Inc* magazine at 17 and published a guide to running start-ups at 19.

But not all successful entrepreneurs are kids. Harland Sanders started franchising Kentucky Fried Chicken when he was 65. Gary Burrell was 52 when he left Allied Signal to help start Garmin, a GPS giant. Herb Kelleher was 40 when he founded Southwest Airlines, a business that pioneered no-frills discount flying in America. The Kauffman Foundation examined 652 American-born bosses of technology companies set up in 1995-2005 and found that the average boss was 39 when he or she started. The number of founders over 50 was twice as large as that under 25.

The third myth is that entrepreneurship is driven mainly by venture capital. This certainly matters in capital-intensive industries such as high-tech and biotechnology; it can also help start-ups to grow very rapidly. And venture capitalists provide entrepreneurs with advice, contacts and management skills as well as money.

But most venture capital goes into just a narrow sliver of business: computer hardware and software, semiconductors, telecommunications and biotechnology. Venture capitalists fund only a small fraction of start-ups. The money for the vast majority comes from personal debt or from the "three fs"—friends, fools and families. Google is often quoted as a triumph of the venture-capital industry, but Messrs Brin and Page founded the company without any money at all and launched it with about $1m raised from friends and connections.

Monitor, a management consultancy that has recently conducted an extensive survey of entrepreneurs, emphasises the importance of "angel" investors, who operate somewhere in the middle ground between venture capitalists and family and friends. They usually have some personal connection with their chosen entrepreneur and are more likely than venture capitalists to invest in a business when it is little more than a budding idea.

The fourth myth is that to succeed, entrepreneurs must produce some world-changing new product. Sir Ronald Cohen, the founder of Apax Partners, one of Europe's most successful venture-capital companies, points out that some of the most successful entrepreneurs concentrate on processes rather than products. Richard Branson made flying less tedious by providing his customers with entertainment. Fred Smith built a billion-dollar business by improving the delivery of packages. Oprah Winfrey has become America's richest self-made woman through successful brand management.

The fifth myth is that entrepreneurship cannot flourish in big companies. Many entrepreneurs are sworn enemies of large corporations, and many policymakers measure entrepreneurship by the number of small-business start-ups. This makes some sense. Start-ups are often more innovative than established

companies because their incentives are sharper: they need to break into the market, and owner-entrepreneurs can do much better than even the most innovative company man.

Big can be beautiful too

But many big companies work hard to keep their people on their entrepreneurial toes. Johnson & Johnson operates like a holding company that provides financial muscle and marketing skills to internal entrepreneurs. Jack Welch tried to transform General Electric from a Goliath into a collection of entrepreneurial Davids. Jorma Ollila transformed Nokia, a long-established Finnish firm, from a maker of rubber boots and cables into a mobile-phone giant; his successor as boss of the company, Olli-Pekka Kallasvuo, is now talking about turning it into an internet company. Such men belong firmly in the pantheon of entrepreneurs.

Just as importantly, big firms often provide start-ups with their bread and butter. In many industries, especially pharmaceuticals and telecoms, the giants contract out innovation to smaller companies. Procter & Gamble tries to get half of its innovations from outside its own labs. Microsoft works closely with a network of 750,000 small companies around the world. Some 3,500 companies have grown up in Nokia's shadow.

But how is the new enthusiasm for entrepreneurship standing up to the worldwide economic downturn? Entrepreneurs are being presented with huge practical problems. Customers are harder to find. Suppliers are becoming less accommodating. Capital is harder to raise. In America venture-capital investment in the fourth quarter of 2008 was down to $5.4 billion, 33% lower than a year earlier. Risk, the lifeblood of the entrepreneurial economy, is becoming something to be avoided.

Misfortune and fortune

The downturn is also confronting supporters of entrepreneurial capitalism with some awkward questions. Why have so many once-celebrated entrepreneurs turned out to be crooks? And why has the free-wheeling culture of Wall Street produced such disastrous results?

For many the change in public mood is equally worrying. Back in 2002, in the wake of the scandal over Enron, a dubious energy-trading company, Congress made life more difficult for start-ups with the Sarbanes-Oxley legislation on corporate governance. Now it is busy propping up failed companies such as General Motors and throwing huge sums of money at the public sector. Newt Gingrich, a Republican former speaker of America's House of Representatives, worries that potential entrepreneurs may now be asking themselves: "Why not get a nice, safe government job instead?"

Yet the threat to entrepreneurship, both practical and ideological, can be exaggerated. The downturn has advantages as well as drawbacks. Talented staff are easier to find and office space is cheaper to rent. Harder times will eliminate the also-rans and, in the long run, could make it easier for the survivors to grow. As Schumpeter pointed out, downturns can act as a "good cold shower for the economic system", releasing capital and labour from dying sectors and allowing newcomers to recombine in imaginative new ways.

Schumpeter also said that all established businesses are "standing on ground that is crumbling beneath their feet". Today the ground is far less solid than it was in his day, so the opportunities for entrepreneurs are correspondingly more numerous. The information age is making it ever easier for ordinary people to start businesses and harder for incumbents to defend their territory. Back in 1960 the composition of the *Fortune* 500 was so stable that it took 20 years for a third of the constitutent companies to change. Now it takes only four years.

There are many reasons for this. First, the information revolution has helped to unbundle existing companies. In 1937 Ronald Coase argued, in his path-breaking article on "The Nature of the Firm", that companies make economic sense when the bureaucratic cost of performing transactions under one roof is less than the cost of doing the same thing through the market. Second, economic growth is being driven by industries such as computing and telecommunications where innovation is particularly important. Third, advanced economies are characterised by a shift from manufacturing to services. Service firms are usually smaller than manufacturing firms and there are fewer barriers to entry.

Microsoft, Genentech, Gap and The Limited were all founded during recessions. Hewlett-Packard, Geophysical Service (now Texas Instruments), United Technologies, Polaroid and Revlon started in the Depression. Opinion polls suggest that entrepreneurs see a good as well as a bad side to the recession. In a survey carried out in eight emerging markets last November for Endeavor, a pressure group, 85% of the entrepreneurs questioned said they had already felt the impact of the crisis and 88% thought that worse was yet to come. But they also predicted, on average, that their businesses would grow by 31% and their workforces by 12% this year. Half of them thought they would be able to hire better people and 39% said there would be less competition.

All in the mind

Mar 12th 2009
From The Economist print edition

A different breed of manager

IN 1995 Captain G.R. Gopinath, a retired military officer, had a chance encounter with an unemployed helicopter pilot that got him started on setting up India's first helicopter company. He spent three years lobbying government bureaucrats to obtain the necessary licences and sold all his possessions and mortgaged his house to raise capital.

Even in his darkest years he never had any doubt that he was destined for success. "I knew this could not go wrong. I knew the money would come," he says. And sure enough his business eventually took off. That allowed him to pursue a new vision—cheap flights. Why should Indians travel the length and breadth of their huge country on trains when Americans got on planes? He established India's first low-cost airline, Air Deccan, pushing the government to relax regulations and using the internet to cut booking costs.

Entrepreneurs operate in all kinds of ways. Some see a market opportunity and draw up a business plan to take advantage of it. Others are more like the captain, driven by an inner force to start a business and unwilling to take "no" for an answer.

A growing body of evidence suggests that entrepreneurs have certain distinctive psychological traits. Noam Wasserman, of HBS, suggests that many entrepreneurs are unusually, sometimes excessively, confident. They are convinced that, against all the odds, they will be able to turn their dream into reality. This sometimes allows them to do something at which most people fail, but it also means they hardly ever hit the forecasts in their business plans.

According to Mr Wasserman, entrepreneurs are strongly attached to their companies. They habitually talk about "their babies". This motivates them to give their all to their companies, whether they make money or not. But it can also be their Achilles heel. Once they get started, they hate giving up control of their companies, even if they are no good at management.

Entrepreneurs are also highly tolerant of risk. A group of scientists at Cambridge University studied the brains of 16 entrepreneurs, chosen because they had started at least two high-tech companies, as well as 17 regular managers. They found that when making rational decisions, the two groups produced the same results. But when making "hot" or risky decisions, entrepreneurs were consistently bolder.

Entrepreneurs also share some more surprising psychological traits. Julie Logan, of the Cass Business School in London, found in separate surveys in 2001 and 2007 that 20% of the British entrepreneurs and 35% of the American entrepreneurs she studied were dyslexic. (By contrast, only 1% of corporate managers are similarly afflicted.) Famous dyslexic businessmen include Richard Branson, Charles Schwab, Ted Turner, John Chambers and Henry Ford. Two possible explanations are that dyslexics learn early in life to delegate certain tasks to trustworthy people, and that they do well in business to make up for doing badly at school.

Economist.com SPECIAL REPORTS

An idea whose time has come

Mar 12th 2009
From The Economist print edition

Entrepreneurialism has become cool

VICTOR HUGO once remarked: "You can resist an invading army; you cannot resist an idea whose time has come." Today entrepreneurship is such an idea.

The triumph of entrepreneurship is driven by profound technological change. A trio of inventions—the personal computer, the mobile phone and the internet—is democratising entrepreneurship at a cracking pace. Today even cash-strapped innovators can reach markets that were once the prerogative of giant organisations.

The internet provides a cheap platform for entrepreneurs to build interactive businesses. Meg Whitman grew rich by developing an online marketplace, eBay, where people could buy and sell without ever meeting. An army of pyjama-clad bloggers has repeatedly outsmarted long-established newspapers on breaking stories. Automated news-collecting services such as RealClearPolitics and Memeorandum, using tiny amounts of capital, have established themselves as indispensable tools for news junkies.

The development of "cloud computing" is giving small outfits yet more opportunity to enjoy the advantages of big organisations with none of the sunk costs. People running small businesses, whether they are in their own offices or in a hotel half-way round the world, can use personal computers or laptops to gain access to sophisticated business services.

The mobile phone has been almost as revolutionary. About 3.3 billion people, or half the world's population, already have access to one. The technology has allowed entrepreneurs to break into what used to be one of the world's most regulated markets, telecoms. And many developing countries have been able to leapfrog rich ones by going straight to mobile phones, cutting out landlines.

This has resulted in a cascade of entrepreneurship. Iqbal Quadir, a Bangladeshi who emigrated to America to become an investment banker and then a business academic, had a dream of bringing mobile phones to his homeland. He struck up a relationship with Muhammad Yunus, the founder of Grameen Bank, which provides microfinance, to turn the dream into reality. If the bank was willing to lend women money to buy cows, why not mobile phones? Bangladesh now has 270,000 phone ladies who borrow money to buy specially designed mobile-phone kits equipped with long-lasting batteries, and sell time on their phones to local villagers. Grameen has become Bangladesh's largest telecoms provider, with annual revenues of around $1 billion; and the entrepreneurial phone ladies have plugged their villages into the wider economy.

Thanks to the combination of touch-screen technology and ever faster wireless networks, the mobile phone is becoming the platform of choice for techno-entrepreneurs. Since July last year Apple has allowed third parties to post some 20,000 programs or applications on its "app store", allowing phones to do anything from identifying the singer of a song on the radio to imitating the sound of flatulence. So far around 500m "apps" have been downloaded for about a dollar a time.

These developments have been reinforced by broad cultural changes that have brought entrepreneurialism into the mainstream. An activity that was once regarded as peripheral, perhaps even reprehensible, has become cool, celebrated by politicians and embraced by the rising generation.

Britain's Oxford University used to nurture one of the longest traditions of anti-entrepreneurial prejudice in the world. The dons valued "gentlemanly" subjects such as classics or philosophy over anything that smacked of "utility". ("He gets degrees in making jam/at Liverpool and Birmingham," went one popular ditty.) The students dreamed of careers in the civil service or the law rather than business, still less entrepreneurship. "How I hate that man," was the writer C.S. Lewis's tart comment on Lord Nuffield, his city's greatest entrepreneur and his university's most generous benefactor.

Today Oxford has a thriving business school, the Saïd School, with a centre for entrepreneurship and innovation and a growing business park that tries to mix the university's scientists with entrepreneurs. Oxford Entrepreneurs is one of the university's most popular societies, with 3,600 student members and a record of creating about six start-ups a year.

The best and the worst 1

Ease of doing business rankings

Top ten

2009	2008	Business region
1	1	Singapore
2	2	New Zealand
3	3	United States
4	4	Hong Kong
5	5	Denmark
6	6	Britain
7	7	Ireland
8	8	Canada
9	10	Australia
10	9	Norway

Bottom ten

2009	2008	Business region
172	171	Niger
173	173	Eritrea
174	175	Venezuela
175	176	Chad
176	177	São Tomé and Principe
177	174	Burundi
178	178	Congo-Brazzaville
179	179	Guinea-Bissau
180	180	Central African Republic
181	181	Congo

Source: World Bank *Doing Business* database

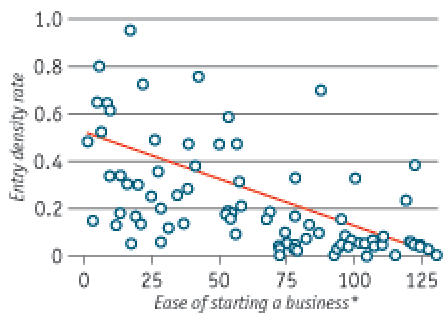
No longer niche

The story of Oxford's conversion to entrepreneurship is being repeated the world over as a growing number of respectable economists discover the new creed. For most of the post-war period entrepreneurs were all but banished from economics. Practitioners concentrated on the traditional factors of production—land, labour and capital—and on the price mechanism. Schumpeter was almost alone in arguing that the most vital competitive weapon was not lower prices but new ideas.

Today entrepreneurship is very much part of economics. Economists have realised that, in a knowledge-based economy, entrepreneurs play a central role in creating new companies, commercialising new ideas and, just as importantly, engaging in sustained experiments in what works and what does not. William Baumol has put entrepreneurs at the centre of his theory of growth. Paul Romer, of Stanford University, argues that "economic growth occurs whenever people take resources and rearrange them in ways that are more valuable…[It] springs from better recipes, not just more cooking." Edmund Phelps, a Nobel prize-winner, argues that attitudes to entrepreneurship have a big impact on economic growth.

Better mousetraps 2

Relationship between regulatory environment and business entry density



*Low = easier, high = harder

Source: World Bank Group Entrepreneurship Survey (2008), *Doing Business* (2009)

Another reason for entrepreneurship becoming mainstream is that the social contract between big companies and their employees has been broken. Under managed capitalism, big companies offered long-term security in return for unflinching loyalty. But from the 1980s onwards, first in America and then in other advanced economies, big companies began slimming their workforces. This made a huge difference to people's experience at the workplace. In the 1960s workers had had an average of four different employers by the time they reached 65. Today they have had eight by the time they are 30. People's attitudes to security and risk also changed. If a job in a big organisation can so easily disappear, it seems less attractive. Better to create your own.

Yet another reason for the mainstreaming of entrepreneurship is that so many institutions have given it their support. In 1998 HBS made entrepreneurship one of the foundation stones of business education, partly in response to demand from students. The school's Arthur Rock Centre for Entrepreneurship now employs over 30 professors. Between 1999 and 2003 the number of endowed chairs in entrepreneurship in America grew from 237 to 406 and in the rest of the world from 271 to 536.

The media have also played a part. "Dragons' Den", a television programme featuring entrepreneurs pitching their ideas to businesspeople in order to attract venture capital, is shown in 12 countries. "The Apprentice", a programme that had Donald Trump looking for a protégé, has produced numerous spin-offs. Even China's state-owned Central Television has a show about entrepreneurs pitching ideas to try to win $1.3m in seed money.

A welcome mat for business

The world's governments are now competing to see who can create the most pro-business environment. In 2003 the World Bank began to publish an annual report called *Doing Business*, rating countries for their business-friendliness by measuring things like business regulations, property rights and access to credit. It demonstrated with a wealth of data that economic prosperity is closely correlated with a pro-business environment. This might sound obvious. But *Doing Business* did two things that were not quite so obvious: it put precise numbers on things that people had known about only vaguely, and it allowed citizens and investors to compare their country with 180 others.

This "naming and shaming" caused countries to compete fiercely to improve their position in the World Bank's rankings. Since 2004 various countries have brought in more than 1,000 reforms. Three of the top reformers in 2007-08 were African—Senegal, Burkina Faso and Botswana. Saudi Arabia too has made a lot of progress. *Doing Business* is also encouraging countries to learn from each other.

Most rich countries are working all the time to make it easier to start new businesses. In Canada, for example, it is now possible to start a business with just one procedure. But the list of top reformers includes all sorts of unexpected places, and the range of reforms that have been undertaken is impressive. India has concentrated on technology, for example, introducing electronic registration for businesses; China has put a great deal of effort into improving access to credit. Robert Litan, of the Kauffman Foundation, suggests that the World Bank may have done more good by compiling *Doing Business* than by lending much of the money that it has.

The United States of Entrepreneurs

Mar 12th 2009
From The Economist print edition

America still leads the world

FOR all its current economic woes, America remains a beacon of entrepreneurialism. Between 1996 and 2004 it created an average of 550,000 small businesses every month. Many of those small businesses rapidly grow big. The world's largest company, Wal-Mart, was founded in 1962 and did not go public until a decade later; multi-million dollar companies such as Google and Facebook barely existed a decade ago.

America was the first country, in the late 1970s, to ditch managerial capitalism for the entrepreneurial variety. After the second world war J.K. Galbraith was still convinced that the modern corporation had replaced "the entrepreneur as the directing force of the enterprise with management". Big business and big labour worked with big government to deliver predictable economic growth. But as that growth turned into stagflation, an army of innovators, particularly in the computer and finance industries, exposed the shortcomings of the old industrial corporation and launched a wave of entrepreneurship.

America has found the transition to a more entrepreneurial economy easier than its competitors because entrepreneurialism is so deeply rooted in its history. It was founded and then settled by innovators and risk-takers who were willing to sacrifice old certainties for new opportunities. American schoolchildren are raised on stories about inventors such as Benjamin Franklin and Thomas Edison. Entrepreneurs such as Andrew Carnegie and Henry Ford are celebrated in monuments all over the place. One of the country's most popular television programmes, currently being recycled as a film, features the *USS Enterprise* boldly going where no man had gone before.

If anything, America's infatuation with entrepreneurialism has deepened further of late. People like Bill Gates and Steve Jobs have all the upsides of Carnegie and Ford without the downsides—the useful products and the open-handed philanthropy without the sweatshops and the massacres. Preachers style themselves as pastorpreneurs. Business books sell in their millions. "When I was in college, guys usually pretended they were in a band," comments one observer. "Now they pretend they are in a start-up."

Advantage America

American companies have an unusual freedom to hire and fire workers, and American citizens have an unusual belief that, for all their recent travails, their fate still lies in their own hands. They are comfortable with the risk-taking that is at the heart of entrepreneurialism. The rewards for success can be huge—Google's Mr Brin was a billionaire by the time he was 30—and the punishments for failure are often trivial. In some countries bankruptcy spells social death. In America, particularly in Silicon Valley, it is a badge of honour.

America also has several structural advantages when it comes to entrepreneurship. The first is the world's most mature venture-capital industry. America's first venture fund, the American Research and Development Corporation, was founded in 1946; today the industry has an unrivalled mixture of resources, expertise and customers. Highland Capital Partners receives about 10,000 plausible business plans a year, conducts about 1,000 meetings followed by 400 company visits and ends up making 10-20 investments a year, all of which are guaranteed to receive an enormous amount of time and expertise. IHS Global Insight, a consultancy, calculates that in 2005 companies that were once backed by venture capitalists accounted for nearly 17% of America's GDP and 9% of private-sector employment.

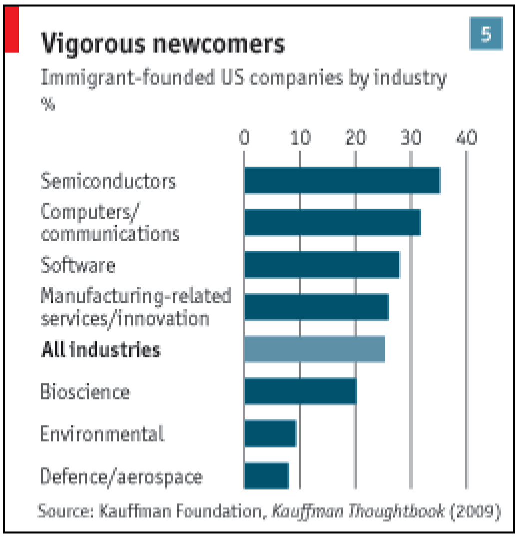
The second advantage is a tradition of close relations between universities and industry. America's universities are economic

engines rather than ivory towers, with proliferating science parks, technology offices, business incubators and venture funds. Stanford University gained around $200m in stock when Google went public. It is so keen on promoting entrepreneurship that it has created a monopoly-like game to teach its professors how to become entrepreneurs. About half of the start-ups in the Valley have their roots in the university.

The third advantage is an immigration policy that, historically, has been fairly open. Vivek Wadhwa, of Duke University, notes that 52% of Silicon Valley start-ups were founded by immigrants, up from around a quarter ten years ago. In all, a quarter of America's science and technology start-ups, generating $52 billion and employing 450,000 people, have had somebody born abroad as either their CEO or their chief technology officer. In 2006 foreign nationals were named as inventors or co-inventors in a quarter of American patent applications, up from 7.6% in 1998.

Amar Bhidé, of Columbia University, suggests a fourth reason for America's entrepreneurial success—"venturesome consumers". Americans are unusually willing to try new products of all sorts, even if it means teaching themselves new skills and eating into their savings; they are also unusually willing to pester manufacturers to improve their products. Apple sold half a million iPhones in its first weekend.

America faces numerous threats to this remarkable entrepreneurial ecology. The legal system can be burdensome, even destructive. One of the biggest new problems comes from "patent trolls"—lawyers who bring cases against companies for violating this or that trumped-up patent. Because the tax system is so complicated, many companies have to devote a lot of time and ingenuity to filling out tax forms that could be better spent on doing business. And the combination of the terrorist attacks on America on September 11th 2001 and rising xenophobia is making the country less open to immigrants.



Today more than 1m people are waiting in line to be granted legal status as permanent residents. Yet only 85,000 visas a year are allocated to the sort of skilled workers the economy needs, and there are caps of 10,000 on the number of visas available for applicants from any one country, so the wait for people from countries with the largest populations, such as India and China, is close to six years.

Illustration by Nick Dewar

Yet despite these problems, America plays a vital role in spreading the culture of entrepreneurialism around the world. People the world over admire its ability to produce world-changing entrepreneurs, such as Bill Gates, wealth-creating universities, such as Harvard and Stanford, and world-beating clusters, such as Silicon Valley. Simon Cook, of DFJ Esprit, a venture-capital company, argues that Silicon Valley's most successful export is not Google or Apple but the idea of Silicon Valley itself.

Foreigners who were educated in America's great universities have helped to spread the gospel of entrepreneurialism. Two of Europe's leading evangelists, Sir Ronald Cohen and Bert Twaalfhoven, were both products of HBS. Chinese and Indian entrepreneurs, who cut their teeth in Stanford and Silicon Valley, are now returning home in ever larger numbers, determined to recreate Silicon Valley's magic in Bangalore or Shanghai.

America is putting hard financial muscle behind this soft power. The Kauffman Foundation spends about $90m a year, from assets of about $2.1 billion, to make the case for entrepreneurialism, supporting academic research, training would-be entrepreneurs and sponsoring "Global Entrepreneurship Week", which last year involved 75 countries. Goldman Sachs is spending $100m over the next five years to promote entrepreneurialism among women in the developing world, particularly through management education.

Old Europe

The other two of the world's three biggest developed economies—the EU and Japan—are far less entrepreneurial. The number of innovative entrepreneurs in Germany, for instance, is less than half that in America, according to the Global Entrepreneurship Monitor (GEM), a joint venture between the London Business School and Babson College. And far fewer start-ups in those countries become big businesses. Janez Potocnik, the EU commissioner for science and research, points out that only 5% of European companies created from scratch since 1980 have made it into the list of the 1,000 biggest EU companies by market capitalisation. The equivalent figure for America is 22%.

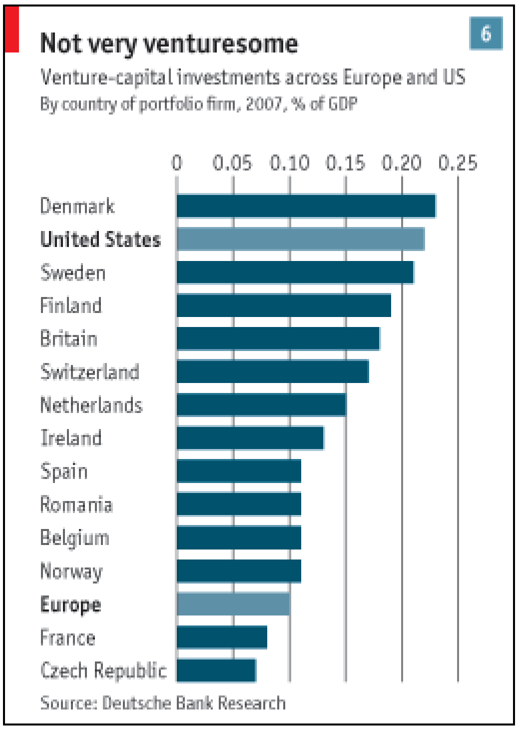
This reflects different cultural attitudes. Europeans have less to gain from taking business risks, thanks to higher tax rates, and more to lose, thanks to more punitive attitudes to bankruptcy (German law, for example, prevents anyone who has ever been bankrupt from becoming a CEO). When Denis Payre was thinking about leaving a safe job in Oracle to start a company in the late 1980s, his French friends gave him ten reasons to stay put whereas his American friends gave him ten reasons to get on his bike. In January last year Mr Payre's start-up, Business Objects, was sold to Germany's SAP for €4.8 billion.

European egalitarianism, too, militates against entrepreneurialism: the EU is much more interested in promoting small businesses in general than in fostering high-growth companies. The Europeans' appetite for time off does not help. Workers are guaranteed a minimum of four weeks' holidays a year whereas Americans' vacations are much less certain. Europeans are also much more suspicious of business. According to a Eurobarometer poll, 42% of them think that entrepreneurs exploit other people's work, compared with 26% of Americans.

These cultural problems are reinforced by structural ones. The European market remains much more fragmented than the American one: entrepreneurs have to grapple with a patchwork of legal codes and an expensive and time-consuming patent system. In many countries the tax system and the labour laws discourage companies from growing above a certain size. A depressing number of European universities remain suspicious of industry, subsisting on declining state subsidies but still unwilling to embrace the private sector.

The European venture-capital industry, too, is less developed than the American one (significantly, in many countries it is called "risk" capital rather than "venture" capital). In 2005, for example, European venture capitalists invested €12.7 billion in Europe whereas American venture capitalists invested €17.4 billion in America. America has at least 50 times as many "angel" investors as Europe, thanks to the taxman's greater forbearance.

Yet for all its structural and cultural problems, Europe has started to change, not least because America's venture capitalists have recently started to export their model. In the 1990s Silicon Valley's moneybags believed that they should invest "no further than 20 miles from their offices", but lately the Valley's finest have been establishing offices in Asia and Europe. This is partly because they recognise that technological breakthroughs are being made in many more places, but partly also because they believe that applying American methods to new economies can start a torrent of entrepreneurial creativity.



Between 2003 and 2006 European venture-capital investment grew by an average of 23% a year, compared with just 0.3% a year in America. Indeed, three European countries, Denmark, Sweden and Britain, have bigger venture-capital industries, in relation to the size of their economies, than America. Venture-capital-backed start-ups have produced more than 100 "exits" (stockmarket flotations or sales to established companies) worth more than $100m since 2004. Tele Atlas, a Dutch mapping outfit, was recently bought by TomTom for $4.3 billion.

The success of Skype, which pioneered internet-based telephone calls, was a striking example of the new European entrepreneurialism. The company was started by a Swede and a Dane who contracted out much of their work to computer programmers in Estonia. In 2005 they sold it to eBay for $2.6 billion.

Several European universities have become high-tech hubs. Britain's Cambridge, for example, has

spawned more than 3,000 companies and created more than 200 millionaires in the university. The accession of ten eastern European countries to the EU has also tapped into an internal European supply of scientists and technologists who are willing to work for a small fraction of the cost of their pampered western neighbours.

Slowcoach Japan

The Japanese can hardly be accused of aversion to long hours. Big Japanese companies have an impressive record of incremental improvement, particularly in the electronics business. But for the most part the Japanese have been less successful than the Europeans at adapting to entrepreneurial capitalism. The latest GEM global report gives Japan the lowest score for entrepreneurship of any big country, placing it joint bottom with Greece. The brightest people want to work for large companies, with which the big banks work hand in glove, or for the government. Risk capital is rare. Bankruptcy is severely punished. And the small-business sector is wrapped in cotton wool, encouraging "replicative" rather than "innovative" behaviour. Over the past quarter-century the rate at which Japan has been creating new businesses has been only one-third to half that in America.

The more the merrier

Mar 12th 2009
From The Economist print edition

India and China are creating millions of entrepreneurs

Illustration by Nick Dewar

GURCHARAN DAS, an Indian venture capitalist, consultant and author, tells a story about stopping at a roadside café in southern India and chatting to a 14-year-old boy who was waiting at tables. The boy said that he needed the money to pay for computer lessons. His ultimate ambition was to run a computer company just like his hero, Bilgay, the richest man in the world. He may have got the name slightly wrong, but the sentiment was spot on.

Over the past couple of decades India has been transformed from a licence Raj into a land of uncaged entrepreneurs. Everybody knows about companies like Infosys, but there is more to Indian entrepreneurialism than software. Bollywood produces 1,000 films a year that are watched by 3.6 billion people (the figures for Hollywood are 700 and 2.6 billion). The Narayana Hrudayalaya hospital, founded by Devi Shetty on the outskirts of Bangalore, is turning heart surgery into a Wal-Mart-like business. Kingfisher beer is popular wherever spicy curries are eaten. The global slowdown will no doubt pose serious problems for India. But the country’s mood has changed fundamentally since the government began opening up the economy in 1991: fatalism has been replaced by can-do optimism.

India has drawn heavily on its expatriate population, particularly the 1m who live in America, to kickstart its entrepreneurial economy. Rajat Gupta, a former head of McKinsey, did as much as anybody to create the Indian Business School in Hyderabad. Gururaj Deshpande, who sold his company, Cascade Communications, to Ascend for $3.7 billion, is a ubiquitous cheerleader for entrepreneurialism. Draper International, which in 1995 became the first foreign venture-capital fund to invest in India, relied on money from Silicon Valley’s Indian community.

India has now begun to reverse the brain drain, summoning its prodigal children back home. In 2003-05 some 5,000 tech-savvy Indians with more than five years’ experience of working in America returned to India. Such people have helped to fill some of the skills gaps created by the country’s recent boom. They have also reinforced India’s already numerous links with high-tech America.

India’s other advantage is its higher-education system, the top end of which is very good at discovering and developing first-class brains. The British introduced the ideal of meritocracy to India; Jawaharlal Nehru gave it a technocratic twist by launching the Indian Institutes of Technology; and India’s natural love of argument did the rest. These institutes, so oversubscribed that only one in 75 applicants gets in, are now as bent on producing entrepreneurs as they were once determined to produce Fabian technicians.

From knock-off to innovation

Communist China's conversion to entrepreneurialism is even more surprising than Fabian India's. When Wu Yi, the country's then vice-premier, visited America in 2006, she took more than 200 entrepreneurs with her. About 60 Chinese companies are now traded on NASDAQ. The Central Party school even offers special courses for entrepreneurs, known as red capitalists.

In some ways China has had a more difficult task than India. The Cultural Revolution destroyed the country's intellectual and managerial capital. Few Chinese speak good English. The state is more interested in grand projects—from state-owned companies to giant infrastructure schemes—than in letting a hundred flowers bloom. But China shares one important advantage with India: the army of overseas Chinese who have made their home in America, particularly Silicon Valley. China has used them well.

The Chinese authorities are fully aware of the part that the overseas Chinese played in Taiwan's economic take-off. Since the late 1990s they have been doing everything they could to tempt expats back, upgrading their universities, often working with foreign institutions, setting up science parks and welcoming foreign companies. So many Chinese expats have returned in the past few years that Valley-slang has given them a special name, B2C (back to China).

Many of China's most successful entrepreneurs have done little more than produce knock-offs of American companies, mostly those they studied when they first went to America. Baidu is a Chinese Google; Dangdang is a Chinese Amazon; Taobao is a Chinese eBay; Oak Pacific Interactive is a mishmash of MySpace, YouTube, Facebook and Craigslist; Chinacars is a Chinese American Automobile Association. But even producing knock-offs takes skill, particularly when the original companies are determined to colonise the Chinese market. And imitative Chinese entrepreneurs can bring innovative management methods to China. Baidu's founder, Robin Li, raised funds from American venture capitalists and offered stock options to his earliest employees.

China is also producing some genuinely innovative entrepreneurs. Jack Ma uses a website, Alibaba, to sell goods from China's thousands of corner shops to other businesses. Mr Ma has also created a college for entrepreneurs. Jeff Chen has developed an internet browser which has attracted venture capital from Denmark and is available in 20 languages.

Some of the most innovative entrepreneurs are working with mobile telephony, which is even more important in China than it is in the West. Liu Yingkui is selling insurance, mutual funds and bank services over the mobile internet. Charles Wang is trying to get subscribers addicted to his free text-messaging service, PingCo, so that he can start signing them up for premium services such as backing up address books, selling astrological charts and providing weather updates.

Watch this space

Both India and China have a long way to go. The Indian government is a lumbering elephant riddled with favouritism, the country's legal processes move at glacial speed, much of the infrastructure is a mess and over a third of the people are illiterate.

As for China, Yasheng Huang, of the Massachusetts Institute of Technology, has shown how Chinese capitalism is being distorted by the influence of politics. Some 40% of entrepreneurs are members of the Communist Party. State-backed businesses receive a disproportionate share of capital. Even sound businesses are frequently opaque: the Chinese reportedly maintain three sets of books, one for their bankers, one for their accountants and one for the government. Businessmen often neglect their firms because they spend so much time cultivating political connections.

But both countries have already come a long way. HBS's Tarun Khanna points out that the entrepreneurial spirit is beginning to breathe new life into India's public sector. Bangalore has replaced its dilapidated airport with a splendid new one, with the help of some private money. As for China's red capitalists, however much they are being held back by the party, they in turn are forcing the party to change.

The opening up of China and India is releasing millions of new entrepreneurs onto the world market. Many of them have already shown themselves able not just to translate Western ideas into their local idioms but also to drive technological advance of their own. The world has only just begun to feel the effects.

Lands of opportunity

Mar 12th 2009
From The Economist print edition

Israel, Denmark and Singapore show how entrepreneurialism can thrive in different climates

DOV MORAN'S desk is littered with the carcasses of dismembered phones. Mr Moran has already had one big breakthrough: inventing the now ubiquitous memory stick. But he dreams of another one: he wants to separate the "brains" of the various gizmos that dominate our lives from the "bodies" to enable people to carry around tiny devices that they will be able to plug into anything from phones to cameras to computers. Mr Moran sold his memory-stick business to SanDisk for $1.6 billion, creating a thriving technology cluster near his office. This time he wants to build an Israeli business that will last, challenging the giants of the camera and phone businesses.

Israel is full of would-be Dov Morans. It is home to 4,000 high-tech companies, more than 100 venture-capital funds and a growing health-care industry. Innovations developed in the country include the Pentium chip (Intel), voicemail (Comverse), instant messaging (Mirabilis, Ubique), firewalls (Checkpoint) and the "video pill", which allows doctors to study your insides without the need for invasive surgery.

Even more than other countries, Israel has America to thank for its entrepreneurial take-off. A brigade of American high-tech companies, including Intel and Microsoft, have established research arms there. And a host of Israelis who once emigrated to America in search of education and opportunity have returned home, bringing American assumptions with them. Many Israeli entrepreneurs yo-yo between Silicon Valley and Tel Aviv; almost 70 Israeli companies are traded on NASDAQ.

The Israeli government helped by providing a ready supply of both human and physical capital. Israel has the world's highest ratio of PhDs per person, the highest ratio of engineers and scientists and some of the world's best research universities, notably Technion. The country's native talent was supplemented by the arrival of 400,000 well-educated Jewish refugees from the former Soviet empire.

However, Israel's main qualification for entrepreneurialism is its status as an embattled Jewish state in a sea of Arab hostility. The Israeli army not only works hard to keep the country at the cutting edge of technology, it also trains young Israelis (who are conscripted at 18) in the virtues of teamwork and improvisation. It is strikingly common for young Israelis to start businesses with friends that they met in the army. Add to that a high tolerance of risk, born of a long history and an ever-present danger of attack, and you have the makings of an entrepreneurial firecracker.

Danish dynamism

Compared with a lion like Dov Moran, Frederik Gundelach is a mere cub, but he has some of the same sense of purpose about him. Sitting in one of Denmark's "growth houses" (incubators for entrepreneurs), he places a flask on the table and launches into an elaborate explanation.

Illustration by Nick Dewar

Mr Gundelach claims that he and his father have discovered a novel way of boiling water that does not require the application of heat. He hopes to sell the flask to outdoor types and soldiers, but that is not the limit of his ambition. The chemical reaction that heats the water can also be used to heat or cool houses, he claims, radically reducing the cost of domestic heating and the threat of global warming.

It is too early to say whether Mr Gundelach's flask will turn out to be a miracle in a bottle or a pipedream, but the Danish government is doing everything it can to give him the support he needs. Denmark is engaged in a social experiment to test whether it can embrace capitalist globalisation yet continue to preserve its generous welfare state. The Danish economy has

traditionally been divided between big multinational companies (such as Carlsberg, a brewing behemoth) and a welter of small family firms. The government now wants to add a third economic force: start-ups with the potential for rapid growth.

The government has done everything a tidy-minded Scandinavian country can to cultivate these start-ups. The World Bank ranks Denmark fifth in the world for ease of doing business. There is a network of growth houses—ready-made offices that provide start-ups with many of the advantages of large companies such as consulting advice, legal services and conference rooms. The government has created a public venture-capital fund, the Vaekstfonden, and is now trying to change attitudes to entrepreneurs and promoting "education for entrepreneurship".

When Muslim countries boycotted Danish goods in 2005 after a Danish newspaper published some disrespectful cartoons of the prophet Muhammad, wags joked that this hardly mattered because the only things that Denmark produced were beer and bacon. But the government's embrace of entrepreneurialism is clearly changing the economy. Denmark is already home to about 20% of Europe's biotech companies. It also has thriving clean-technology, fashion and design industries. As a proportion of GDP, Danish companies attract more venture capital than any other European country.

Sizzling Singapore

At first sight Denmark and Singapore do not have much in common, yet they share not only the same official enthusiasm for entrepreneurialism but also many of the same policies. Singapore's government has invested heavily in digital media, bio-engineering, clean technology and water purification, creating huge incubators and enticing foreign scientists with fat pay packets, as well as setting up a public venture-capital fund that has in turn brought in lots of private venture capital. More than 5% of Singapore-based companies are backed by venture capital.

The government has done everything in its power to make life easy for entrepreneurs, which has earned it first place in the World Bank league table for ease of doing business. It is also trying hard to encourage a traditionally passive population to become more innovative. Schools teach the virtues of entrepreneurialism. The universities put ever more emphasis on business education and links with industry. The Nanyang Technological University (whose chairman, like that of the National University of Singapore, is an alumnus of Hewlett-Packard) offers a graduate degree in technopreneurship and innovation.

Singapore sees entrepreneurialism as a prerequisite to future growth. It has spent the past few decades climbing up the "value chain" from manufacturing to services and from trade to finance. Its biggest test yet may be to create knowledge industries and produce companies that can commercialise intellectual breakthroughs.

All three countries have both advantages and disadvantages when it comes to embracing entrepreneurship. Israel depends too heavily on America and is being hit hard by the downturn there. Denmark is too egalitarian. A top personal-income-tax rate of 63% drives the most successful entrepreneurs out of the country.

Singaporeans have even deeper cultural problems with entrepreneurship. The best and brightest have little appetite for risk-taking entrepreneurship, and most people suffer from an excessive fear of bankruptcy, according to Monitor. The country's consumers are anything but venturesome: for all the island's cultural diversity, they remain obsessed by Western brand names. The country is paying a heavy price for this. A Singapore-based company, Creative Technology, invented a digital music player, the NOMAD, two years before Apple launched the iPod, but Creative's NOMAD looked like a clunky CD player rather than a miniature fashion accessory. It received $100m from Apple for patent infringement, but that did not make up for the loss of a mass market.

Still, the governments of all three countries remain enthusiastic supporters of the entrepreneurial idea. The Danes and the Singaporeans regard it as their ticket to success in a global economy and the Israelis

as a matter of survival. All three are also helping to spread the creed in their regions. Arab countries are beginning to realise that the best way to deal with Israel is to copy its vibrant economy. Denmark serves as a model to European leaders such as France’s Nicolas Sarkozy who want to combine dynamism with social protection. The Chinese regard Singapore as a useful laboratory for reform. In the 1980s China asked Goh Keng Swee, Singapore’s former finance minister, to advise on the development of its special economic zones; today it is keeping a watchful eye on the city-state’s model of state-sponsored entrepreneurship.

Magic formula

Mar 12th 2009
From The Economist print edition

The secrets of entrepreneurial success

KING MIDAS wished for everything he touched to turn to gold, which turned out to be a bad idea. His modern equivalents hope that everything they touch will turn to Silicon, which may not be such a good idea either. The world now glories in dozens of would-be Silicon Valleys: Silicon Alley in New York, Silicon Glen in Scotland and even, depressingly, Silicon Roundabout in London.

Siliconitis is the most common example of what is now an almost universal search among policymakers, local as well as central, for the secrets of entrepreneurial success. It is also the most instructive. A few attempts to replicate Silicon Valley, most notably in Israel, have succeeded. But most are embarrassing failures.

The most basic mistake politicians make in trying to foster entrepreneurship is to assume that there is only one model of a successful entrepreneurial cluster. There is no point in trying to create the next Silicon Valley without the Valley's remarkable resources: two world-class universities, Stanford and Berkeley, and a big financial centre, San Francisco. Instead, would-be emulators should concentrate on their own particular strengths.

In addition to the classic Silicon Valley model, Monitor identifies three other successful entrepreneurial ecologies. One is the anchor-firm model. Alfred Marshall, one of the first economists to write about entrepreneurship, said that successful entrepreneurs are like large trees in a forest, towering over their neighbours and depriving them of light and air. In fact, the big trees usually produce lots of little ones. They spin off subsidiaries, provide experience to employees who then decide to go it alone, and nurture dozens of suppliers.

The research triangle in North Carolina was a successful exponent of the anchor-firm model, recruiting big companies such as IBM, Alcatel and Union Carbide which then either spawned or attracted lots of smaller operators. Hindustan Unilever, a food and personal-care giant, is another, less self-conscious exponent. The firm employs 45,000 women across India to market its goods to 150m consumers in rural areas. These saleswomen not only earn an income, they also learn about products, prices and marketing, sending a ripple of entrepreneurship throughout rural India.

A second, currently topical, model is driven by crisis. People become entrepreneurs when the economy stops supplying jobs. This happened in the San Diego region in the 1990s when the end of the cold war threw hundreds of highly trained military scientists out of work. Local start-ups such as Qualcomm hoovered up the talent and put it to new uses.

A third is the local-hero model in which a local entrepreneur sees an opportunity, starts a business and turns it into a giant. When Earl Bakken founded Medtronic in Minneapolis in 1949, he was creating a local industry as well as a company. Having developed the world's first heart pacemaker, Medtronic grew into the largest medical-technology company in the world, spawning huge numbers of smaller ones.

A matter of luck

Two other things complicate the search for success—the role of chance and the importance of culture. The Indian Institutes of Technology were designed to create technocrats rather than entrepreneurs. It was more a matter of luck than good planning that they were churning out exactly the sort of people that the Indian software industry needed.

David Landes, an influential economic historian, has argued that "if we learn anything from the history of economic development, it is that culture makes almost all the difference." You can build as many incubators as you like, but if only 3% of the population want to be entrepreneurs, as in Finland, you will have trouble creating an entrepreneurial economy.

This complicates policymakers' work, but it does not make it impossible. Culture is not the only factor: economic policies matter too. Overseas Indians and Chinese thrived abroad in the 1950s and 60s even though their cousins were languishing back home. And culture can be changed. The Thatcher government shook Britain out of its anti-business torpor in the 1980s. More recently India and China have become the second and third most entrepreneurial countries in the world, trailing only America, according to Monitor.

What should countries do to improve their chances of getting it right? At the minimum, they need to implement the policies that the World Bank lays down in *Doing Business* to achieve things like transparency, convenience and rule of law. At best, they should emulate two qualities of some of the world's most successful entrepreneurial clusters.

The first is a vibrant higher education system. Business is increasingly dependent upon knowledge, particularly technical knowledge. Some 85% of all the high-growth businesses created in America in the past 20 years were launched by college graduates. University research departments have helped to drive innovation in everything from design to entertainment.

The second is openness to outsiders. Emigrés have always been more entrepreneurial than their stay-at-home cousins: the three most entrepreneurial spaces in modern history have been the ones inhabited by the Jewish, Chinese and Indian diasporas. In today's knowledge economy educated émigrés are at the cutting edge of innovation. They create more firms than regular folk; they circulate ideas, money and skills; they fill skills gaps; and they mix and match knowledge from different parts of the world.

Born global

In fact, today's smart entrepreneurs start global. They search for materials, talent and opportunities the world over and define their competitive environment globally rather than locally. This reflects the fact that entrepreneurs are springing up in every corner of the world, complicating the battlefield still further.

Take EyeView, a quintessentially modern start-up, which was a global citizen from its very first day. The company uses "rich media"—a combination of videos and audios—to teach customers how to use websites. Most of the company's customers are international, so the videos are produced in many different languages and watched the world over.

The company currently occupies an upper floor of a nondescript building in Tel Aviv, but in its earliest years it lived on three continents. Two of the company's founders were based in Boston, the third in Sydney and the fourth in Tel Aviv. The company made its first videos in Australia and its first customers were on America's West Coast.

Illustration by Nick Dewar

Daniel Isenberg, of HBS, points out that today's entrepreneurs are pioneering a new business model. In the old days globalisation was incremental. Companies first established themselves in their local markets and then expanded abroad slowly, starting in their own regions. Now a number of them span the globe right from the beginning.

Successful entrepreneurs are coming from some surprising places. Bento Koike has built Tecsis, one of the world's most successful manufacturers of wind-turbine blades, in Brazil, his home country, even though both the company's raw materials and its customers are in Europe and America and the huge blades are difficult to ship. He has taken out a patent on his innovative packaging technology.

New Zealand, despite its geographical isolation, has turned itself into an entrepreneurial powerhouse, leading the world in the creation of small and medium-sized enterprises, thanks in part to enlightened government policies. It has done particularly well with applying innovation to woollen underwear. Its Icebreaker brand is popular with young, image-conscious outdoor enthusiasts.

Successful entrepreneurs are also forming some surprising cross-border collaborations. Shai Agassi, an Israeli-American businessman based in Palo Alto, California, is promising to upend the car industry by

going electric, in alliance with politicians, entrepreneurs and companies in Israel, Denmark, Japan and France. Israel and Denmark are both building networks of recharging stations. Danish entrepreneurs are working on technology that will prolong the life of batteries. Renault and Nissan are building electric cars.

Still, it would be a mistake to conclude from all this that entrepreneurship is killing distance entirely. Many of today's start-ups have to grapple with logistical problems that used to be the preserve of large companies. Entrepreneurs need to travel the world to check on far-flung operations, organise globe-girdling supply chains and comply with a plethora of legal and regulatory systems.

Talk to any budding entrepreneur and you soon discover, too, that local cultures matter. The more globalised the world becomes, the more people look for comparative advantages that cannot easily be bought or replicated; and the more far-flung their business operations, the more entrepreneurs rely on bonds of trust with their fellow businessmen. One reason why Mr Koike decided to base Tecsis in Brazil was that the country has a thriving aerospace industry and a successful Aeronautical Institute of Technology. The two leading founders of EyeView, Tal Riesenfeld and Oren Harnevo, grew up in the same village in Israel and served in the army at the same time. They decided to concentrate their activities in Israel, rather than remaining scattered all over the world, partly because they thought that they needed to share the same "mindspace", and partly because they wanted to do something to help their country.

Saving the world

Mar 12th 2009
From The Economist print edition

Entrepreneurs are trying to do good as well as make money

Illustration by Nick Dewar

THE Iskcon Sri Radha Krishna-Chandra Temple feels like a bit of ancient India preserved in the heart of modern Bangalore. The faithful wait in long lines, their faces daubed with paint. The air is filled with chants of "Hare Krishna" and "Hare Rama". Monks in orange robes offer flowers and food to the gods and produce haunting sounds on conch shells.

In fact, India's entrepreneurial revolution is as visible here as anywhere. The temple has a conference room equipped with state-of-the-art audio-visual aids. Its board of directors includes several leading software billionaires and their wives, providing it with money as well as connections. The monks are entrepreneurs as well as holy men, one moment talking about reincarnation and the next about sustainable delivery models.

The temple provides 200,000 local schoolchildren with free meals every day. It achieves this miracle of abundance by a combination of mechanisation and careful management. The temple's 250 employees use giant machines to clean rice and prepare chapattis. They then pack the food into steel containers and load it into a fleet of custom-made vans which keep the food warm as they crawl through Bangalore's traffic-clogged streets.

Entrepreneurship is reshaping the voluntary sector as much as the private one. Rich people have often turned their hand to philanthropy in their later years, but this old story has acquired some new twists. Today's entrepreneurs routinely apply business techniques to philanthropy. Some of them are even using a venture-capital model, investing in a range of promising start-ups and making longer-term funding conditional on performance.

Riders for Health was created when a couple of motorbike enthusiasts discovered that the vehicles being used by health-care providers in Africa were not being maintained. The organisation now helps to provide 11m people with health care in inaccessible parts of Africa, often using motorbikes. Teach for America started when a Princeton student, Wendy Kopp, conceived the idea of persuading Ivy League graduates to teach in state schools for a while. The trick was to ask them to compete for the honour of doing something that, a few years earlier, none of them would have been remotely interested in. The programme has now been copied around the world.

Social entrepreneurs often blur the distinction between making money and offering charity. Some use the profits from their main business to cross-subsidise their charitable work. India's Aravind Hospitals, which perform 250,000 eye operations a year, do 60% of their work for nothing. Other social entrepreneurs establish for-profit social enterprises, also known as "FOPSEs", that try to make money as well as doing good.

Vinod Kapur, for example, has built a successful company with the purpose of feeding India's rural poor. He invested $1m—and many years of his life—in breeding a superchicken. The result was the Kuroiler: multicoloured, resistant to disease, capable of surviving on farmyard scraps, strong and wily enough to fight off predators, and producing twice as much meat and five times as many eggs as ordinary chickens.

Mr Kapur has built an entire supply chain around the Kuroiler, including specialist farms that breed them and vendors who sell them across rural India.

Shane Immelman has built a successful company by trying to bring the benefits of education to poor schoolchildren in South Africa. Appalled that 4m children did not even have desks, let alone schoolrooms, he invented a “lapdesk” that sits on the child’s lap and provides a stable surface. The desks are covered in advertisements, so Mr Immelman is able to hand them out free, but they have proved so popular that better-off people have started to buy them, and some of them are now being exported to other developing countries.

Take care of the pennies

In the long run, however, the best thing that entrepreneurs can do for the poor may be simply to see them as workers and customers. A rising number of Western companies are pursuing what C.K. Prahalad, a management professor at the Ross School of Business at the University of Michigan, calls “the fortune at the bottom of the pyramid”. Businesspeople have realised that billions of pennies can add up to a lot of money. Cemex, an innovative Mexican cement firm, employs thousands of poor Mexicans. Casas Bahia, a Brazilian retailer, specialises in serving poor customers. India’s ICICI Bank uses technology and customer service to reach poor rural Indians.

Allowing people to experience the benefits of the market sometimes means helping them to join the market economy. Hernando de Soto, a Peruvian economist who helped to inspire the World Bank’s *Doing Business*, has long argued that creating property rights in the developing world is a precondition for encouraging entrepreneurialism there. Regional development banks such as the African Development Bank and the European Bank for Reconstruction and Development claim they are trying to build local environments in which entrepreneurs can flourish.

This seems to hold out the prospect of a continuous cascade of prosperity as successful entrepreneurs discover new markets and then use the fruits of their efforts as social entrepreneurs to generate yet more successful enterprises. But the world is never as simple as that: entrepreneurship creates uncertainty and competition as well as innovation and prosperity.

The entrepreneurial society

Mar 12th 2009
From The Economist print edition

Better, on the whole, than managed capitalism

THE rise of the entrepreneur, which has been gathering speed over the past 30 years, is not just about economics. It also reflects profound changes in attitudes to everything from individual careers to the social contract. It signals the birth of an entrepreneurial society.

How can policymakers adjust to this change? The first thing they need to do is shed some common misconceptions about the meaning of entrepreneurial capitalism. In any discussion of entrepreneurship, the phrase most frequently invoked is Schumpeter's "creative destruction". That can be unhelpful, implying that "destruction" and "creation" carry equal weight and that mankind will be in for a rough time in perpetuity.

Columbia University's Mr Bhidé points out that a great deal of creation is of the non-destructive variety. Rather than displacing existing products and services, many innovations promote and satisfy new demands. William Nordhaus, an economist at Yale University, points out that about 70% of the goods and services consumed in 1991 bore little relationship to those consumed 100 years earlier. There are worlds of non-destructive creation yet to be conquered—new cures for diseases, say, or innovations that will improve the life of elderly people. And even when the creation does involve some destruction, there is usually not a lot of it. Most innovations increase productivity and improve the general standard of living.

It's fine to be brilliant

Entrepreneurialism promotes individual creativity as well as economic dynamism. One of the most chilling chapters in William Whyte's "The Organisation Man" (1956), a study of corporate America at the height of managed capitalism, was entitled "The Fight Against Genius". The thinking at the time was that well-rounded team players would be more valuable than brilliant men, "and a very brilliant man would probably be disruptive." Entrepreneurial capitalism has brought the rehabilitation of the "very brilliant man".

Illustration by Nick Dewar

Entrepreneurial capitalism is not as disruptive as many of its friends—and most of its enemies—imagine. It produces a bigger pie and allows more people to exercise their creative talents. But it is disruptive nonetheless. It increases the rate at which companies are born and die and forces workers to move from one job to another. Policymakers have to find the right balance between flexibility and security.

The most urgent need for reform is in continental Europe. Policymakers in the larger European economies need to learn from the Scandinavian countries that it is possible to have a safety net without clogging up the labour market. If people are hard to sack, start-ups find it more difficult to get off the ground. And high unemployment rates discourage people from branching out on their own because they might not find another job if they fail.

America suffers from serious rigidities of its own. The mobility of American workers is severely restricted by the country's reliance on employer-provided health insurance, a relic of the second world war. New firms often have to pay more for their health care because they have smaller "risk pools" than larger companies. America's health-care system is bad at controlling costs, imposing a heavy burden on the whole economy, particularly the newest and most fragile firms.

“Every generation needs a new revolution,” Thomas Jefferson wrote towards the end of his illustrious life. The revolution for the current generation is the entrepreneurial one. This has spread around the world, from America and Britain to other countries and from the private sector to the public one. It is bringing a great deal of disruption in its wake that is being exaggerated by the current downturn. But it is doing something remarkable: applying more brainpower, in more countries and in more creative ways, to raising productivity and solving social problems. The “gale” that Schumpeter celebrated is blowing us, a little roughly, into a better place.

Sources and acknowledgments

Mar 12th 2009
From The Economist print edition

The author would like to acknowledge the generous help he has received from Harvard Business School and the Ewing Marion Kauffman Foundation. In addition to those named in the text, he would especially like to thank: Suren Dutia, Michael Hay, Anders Hoffman, Koh Boon Hwee, Michael Jacobides, Rosabeth Moss Kanter, Joe Lassiter, Dan Nova, Michael Roberts, Viktor Mayer-Schönberger, William Sahlman, Eddy Shalev and Teng-Kee Tan.

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Mar 12th 2009
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Unions

In from the cold?

Mar 12th 2009 | LONDON, NEW YORK AND WASHINGTON, DC
From The Economist print edition

Capitalism's crisis gives the labour movement a chance to revive and reinvent itself

Reuters

ON MARCH 10th United Technologies, mangled by the economic crisis, became the latest American industrial giant to announce massive layoffs, cutting its workforce by 11,600, or around 5%. Unemployment across the developed world is reaching levels not seen for decades. Yet even though periods of high unemployment are miserable for unwanted workers, it seems they can be good for workers' rights. The crisis in capitalism has strengthened the hand of the unions, which are now viewed more positively in America than they have been since Jimmy Carter occupied the White House. The new president is among their biggest fans.

"We need to level the playing field for workers and the unions that represent their interests," said Barack Obama in a video address to the executive board of the AFL-CIO, America's biggest union federation, which met in Miami this month. (Unlike company bosses, union leaders can still network in sun-kissed luxury without being criticised.) During his administration, Mr Obama told the gathering of chiefs from more than 50 unions, "I want you to know that you will always have a seat at the table." Since Mr Obama took office in January, John Sweeney, the head of AFL-CIO, has visited the White House at least once a week. George Bush invited him once in eight years.

Mr Obama has appointed Hilda Solis, the daughter of a Teamsters shop-steward, as his secretary of labour. He has signed several pieces of union-friendly legislation into law. And despite fierce criticism from business leaders, he remains enthusiastic about the Employee Free Choice bill, better known as the "card check" bill, which was introduced into both houses of Congress this week and would make it easier for employees to unionise. It would be the most significant pro-union reform since the National Labour Relations Act, passed in 1935 as part of the New Deal, which protected the rights of most private-sector workers to form unions and to go on strike.

No wonder, then, that despite the grim economic circumstances, the mood in Miami was decidedly upbeat—and not just among American unionists. John Monks, general secretary of the European Trade Union Confederation, flew in to celebrate the transatlantic renaissance of unionism. "Trade unions in Europe and the US are resurgent," he told the AFL-CIO leadership. "Our ideas are on the table and are being taken seriously."

Mr Monks sees an opportunity to reverse what seemed the inevitable decline in union membership and

influence that began in earnest with the elections of Ronald Reagan and Margaret Thatcher. Now, he says, the collapse of "Goldman Sachs capitalism" means that things have changed. He thinks the potential is greatest in America where unions really were out in the cold. Throughout Europe, meanwhile, despite national differences in attitudes towards unions, "everybody is a social democrat or a socialist now—Merkel, Sarkozy, Gordon Brown," he says. "The wind is in our sails."

Well, maybe. But just because a particular kind of financial capitalism is discredited does not mean workers will simply transfer their allegiance to unions. Rather than trying to resist change or turn back the clock, union leaders need to present some visionary and forward-looking big ideas—not historically their strong suit.

Union leaders are keen to make the most of the moment. In America they have even gone so far as to try to repair the ugly split in the labour movement that occurred in 2005 when seven unions, including the Teamsters and the Service Employees International Union (SEIU), acrimoniously quit the AFL-CIO. Andrew Stern, the modernising head of the SEIU who led the breakaway having fallen out with Mr Sweeney, his former mentor, is not certain the rapprochement will happen. But he has entered talks with the AFL-CIO because he thinks today's circumstances provide a "once-in-a-lifetime opportunity".

Hard choice

Employee Free Choice will provide the first real test of whether the upbeat mood is justified. The business lobby is charging in with all guns blazing, claiming the bill will destroy jobs at a time when unemployment is already soaring, and calling on the president to block it and thereby prove he can put country before party ideology.

Among other things, the bill would end the requirement for a secret ballot of employees to be held before a union can represent a company's workers in collective bargaining, and bring in a new mandatory arbitration system for when negotiations stall. Business groups have reportedly spent tens of millions of dollars fighting the bill, and it may end up being most expensive lobbying battle in history. The unions stress that the bill would make it harder for employers to intimidate workers into opposing unionisation; business groups say ending the secret ballot looks like a backward step in a modern democracy.

Both sides agree the bill would increase union membership, which has plunged to around 8% of the workforce in America, from over 35% in the mid-1950s. They disagree about whether this increase would be good for America, its firms or its workers. A new study by Anne Layne-Farrar of LECG Consulting, paid for in part by the business-backed Alliance to Save Main Street Jobs, claims that the act would raise wages for union members—but by driving up employment costs for firms, it would also increase the unemployment rate in America by as much as eight percentage points and reduce job creation by around 12.5m jobs a year. "These are two adverse consequences that America can ill afford at this time of recession," she concludes.

But even by her own calculations, a lot depends on how much the share of unionised workers increases. If union membership does not increase much—and, in today's labour market, workers may be reluctant to do anything to upset employers—she concedes that the unemployment rate might go up by as little as 0.1 percentage points, and job creation might fall by only 180,000 jobs a year.

A group of 40 leading economists, including three Nobel laureates, Kenneth Arrow, Robert Solow and Joseph Stiglitz, have endorsed a statement published in the *Washington Post* backing Employee Free Choice, arguing that the lack of bargaining power of ordinary American workers had made the economic crisis worse. Given the past failure of public letters by economists to influence policy, however, this may be a bearish signal for bill's chances of becoming law. Already, the SEIU's Mr Stern fears that the voting will be very close: the "epitome of a squeaker".

Unionism, but not as we know it

But even if Employee Free Choice becomes law, it is unlikely on its own to indicate any long-term reversal in the decline of unionism, reckons Richard Epstein, a law professor at the University of Chicago who opposes the bill. Around the world, union membership in every mature market has declined, despite very different legal systems. That suggests that the decline in membership has been the result of workers realising that union-negotiated high wages are risky to jobs. In addition, the greater variation of jobs in the modern workforce has made it harder to implement collective agreements. If the labour movement is

to prosper, it must adopt different strategies and find ways to be relevant to workers in new sorts of jobs.

Mr Stern has raised union membership at the SEIU by targeting low-paid service workers in firms such as those owned by private equity. He has managed to strike innovative deals with some private-equity firms such as Blackstone, while continuing to feud with others, such as KKR, that refuse to come to the table. Other union bosses, he says, have been slow to "wake up to the fact that we are in the third industrial revolution, and that the job-for-a-lifetime economy is over."

Sara Horowitz, a social entrepreneur, has turned the Freelancers Union into America's fastest-growing. Her union addresses the practical needs of independent workers, who now account for around one-third of the workforce. Over the past six months, membership growth has jumped from 2,000 to 3,000 a month, and it now has over 100,000 members.

The nature of their work means the union does not get involved in collective bargaining. Instead, it provides a marketplace for freelance jobs, cheaper health-care insurance (through a for-profit insurance company it has created), and political activism on behalf of its members. A notable success was to convince New York's mayor, Michael Bloomberg, to reduce taxes on freelance work. In the longer term, Ms Horowitz wants a new sort of unemployment-benefit system based on a savings vehicle, rather than insurance. "Two or three years ago, people would cringe if you talked about solidarity," says Ms Horowitz. "Now they say they get it." Unions and associations representing independent workers are, she says, "coming together around common interests".

One fast-growing grassroots organisation is Working America, an affiliate of the AFL-CIO which links union members and non-union workers to campaign for better jobs, higher standards in education and, above all, health-care reform. (Any progress on this front under the Obama administration will be claimed as a success by both AFL-CIO and the breakaway coalition led by Mr Stern.) Moreover, grassroots union activism in several swing states helped Mr Obama to victory. Philip Dine, in his optimistic 2007 book, "State of the Unions", argues that such activism, by showing that unions identify with the needs of ordinary Americans rather than just engage in power plays in Washington, DC, also holds the key to reviving union membership across the board.

There may be similar opportunities in Europe, says Mr Monks, if unions can move beyond their old-fashioned enthusiasm for street protests to campaign for policy changes that broadly benefit workers. "Given the tough labour market, and desperate employers, this is not a time for huge militancy," he says. Instead, "it is a time to demand frameworks of welfare benefits, training, consultation and to put in place fairer pay systems, so that when the economy does recover there is no repeat of the surge in inequality that took place in the past decade."

David Arkless of Manpower, an employment-services firm, thinks that in Europe even more than America, union leaders face a crucial decision about whether to swim with the tide of history or against it. Economies are likely to be changed by the crisis. Those that are flexible enough to move workers out of shrinking industries, and into those with growth potential, will emerge the strongest, he says. Will Europe's unions fight to preserve their privileges in inflexible national labour markets—a strategy that benefits union members at the expense of non-members—or will they throw their lot in with governments and employers to ease the movement of workers to where jobs are, through training and so forth?

In the struggle to define a new model of capitalism, the biggest test for the union movement may be which side to take on globalisation. There have been some notable examples of workers uniting around the world, such as the global deal struck in December with G4S, a giant security company, to allow union recognition for all its 570,000 workers in 100 countries, from America to Africa. When such a big employer does something like this, says Mr Stern, who helped broker the deal, "you should take notice".

But unions have often been on the side of protectionism. Even in good times workers dislike foreigners "stealing" their jobs. In a downturn this can easily lead to full-blown protectionism. Unions have been strong advocates of the "Buy American" campaign to legislate favourable terms for American firms in the economic stimulus package—though they insist that this is not really protectionism, but intended as a temporary response to the crisis.

In Europe, by contrast, unions tend to be less simplistically nationalistic, especially at the top. Britain's union leaders, for example, condemned the recent wildcat strikes against immigrant workers, and Mr Monks is fond of pointing out that workers throughout Europe benefit hugely from the European Union's policy of free movement of labour. One lesson from the Depression in the 1930s, he observes, is "don't tamper with trade."

It is a counsel of perfection, but unions' dealings with employers need not be a zero- or negative-sum game. Winning practical benefits for their members need not mean confrontation and militancy. Forward-looking unionists recognise that the world is changing and are in favour of globalisation and the free movement of labour, both between countries and within them, as the best response to the crisis. The evidence suggests that when unionism takes pragmatic and progressive positions, it can indeed prosper. If it does not take this chance, it may not get another like it.

Pharmaceuticals

Merck's manoeuvres

Mar 12th 2009
From The Economist print edition

In an artfully constructed deal, Merck is to pay $41 billion for Schering-Plough

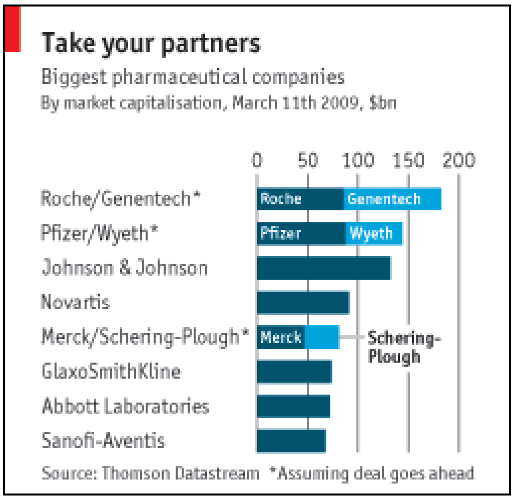
THE language was reminiscent of a happier time before the credit crunch and the economic crisis closed the book on most such mergers. Dick Clark, the boss of Merck, an American pharmaceutical giant, called the agreement to acquire Schering-Plough, which was announced on March 9th, a "transformational event" and went on to expound on the "strategic sense" and "exceptional promise" of the deal.

Perhaps Mr Clark can be forgiven his exuberance. The deal is a bright spot amid a corporate landscape of bankruptcy and retrenchment. Merck will pay $41 billion for Schering-Plough, paying with a combination of shares, $9.8 billion from cash reserves and another $8.5 billion prised from the clutches of a bank, JPMorgan.

Although credit has dried up almost everywhere else, drugs companies, with their cash reserves and healthy revenues, can still call on the banks. Last month Pfizer, another American drugs giant, was able to count on bank loans to assist in its $68 billion acquisition of Wyeth. And on March 12th Switzerland's Roche said it had reached an agreement to pay $46.8 billion for the 44% of Genentech, an American biotech firm, that it does not already own. Sanofi-Aventis of France is also said to be on the acquisition trail.

Big drugs companies hope consolidation will solve their various problems: the lack of new blockbuster drugs coming through their research pipelines, looming competition from generic drugs as patents expire, the global economic crisis and an over-dependence on sales in America, where health-care reforms will squeeze margins, at the very least. Alas, the evidence suggests that many of the supposed benefits of pharmaceutical mega-mergers fail to materialise: bigger firms are no better at innovation, and are often worse. But bosses are pressing ahead anyway.

The main attraction of buying Schering-Plough is that Merck will, in one swoop, double (to 18) the number of drugs it has in late-stage development. Merck will also bolster its international and over-the-counter sales, both areas where Schering is strong (70% of its revenues come from outside America). In addition, Mr Clark promises that there will be cost savings of $3.5 billion a year after 2011. But this sounds dubious, given that both companies are already cutting costs heavily. And if the two firms' research teams are so complementary and do not overlap much, as Merck claims, who is going to get sacked?



A bigger worry is that Johnson & Johnson (J&J), another drugs giant, could spoil the party in one of two ways. It could make a bid for Schering itself (and some analysts think it would make a better partner than Merck). Or J&J could jeopardise its co-marketing agreement with Schering for Remicade, a money-spinning anti-inflammatory drug. J&J has the right to terminate the agreement if there is a change of control at Schering. So Mr Clark is cunningly structuring his deal as a reverse takeover in which Merck will be acquired by Schering-Plough—which will then rename itself Merck. J&J may not be impressed.

Such trickery aside, the deal does at least answer critics who complained that Merck was not acting as vigorously as competitors in buying rivals and moving into new markets. But it also represents a change in strategy for Merck, which unlike many of its peers has stayed on the sidelines during the industry's previous waves of mega-mergers. Instead, the company has always preferred to grow by developing new products in its laboratories. The task for Mr Clark, who will become boss of the new company, will be to make the deal go smoothly, despite his lack of experience with big mergers.

Pfizer's acquisition of Wyeth and Roche's takeover of Genentech are also predicated on cost savings and replenishing the acquiring companies' pipelines. The acquisitions in the pharmaceutical industry do have some logic to them, to the extent that they will provide a short-term boost. But there is also a growing herd mentality, as firms rush to do deals in order not to be left out. And none of these tie-ups does much to address the industry's chief problem—its inability to innovate.

The next Great Wall

Mar 12th 2009 | HONG KONG
From The Economist print edition

“Buy local” campaigns raise protectionist barriers in Asia

POLITICIANS in Europe and America have been especially vocal about the dangers of protectionism in recent months. Even so, many Asian firms feel that barriers are gradually rising against them. Tighter environmental laws, “place of origin” rules and other new regulations are being introduced in America and Europe, they complain. The costs of complying with these regulations make Asian rice, furniture and toys less competitive. As Asian exports continue to collapse, the region is responding in kind.

This week Vietnam increased import tariffs on dairy products, after raising duties on paper last month. India has upped tariffs on some types of steel. Malaysia’s prime minister has issued a plea on his website to “buy local products in large quantities”. The Indonesian government will introduce regulations this month to penalise 4m officials if they do not buy locally produced food, drinks, shoes, clothes, music and films. New rules which favour local steelmakers are also likely to cut Indonesian steel imports to 1.5m tonnes this year, down from 9m tonnes in 2008. Such measures are not protectionist, the Indonesian trade minister claims, but are merely “branding campaigns”.

Perhaps the loudest anti-protectionist calls in the region have come from China. Hours before Hillary Clinton’s visit last month, Zhong Shan, the vice-minister of commerce, said that China “strongly opposes protectionism” and gave warning that it could make the financial crisis worse. Just as America watered down the buy-local clause in its own financial bail-out package, China quietly removed one from its own industry-support bill a few weeks ago. This had instructed “governments of different levels to give priority to home-grown light-industry products”.

But the mere mention of the clause seems to have been enough to make local governments comply. Although Beijing publicly continues to rally against protectionism, China’s provinces are busily erecting internal barriers.

Farmers in Hangzhou now get a 13% subsidy if they buy Hangzhou-made refrigerators, televisions, mobile phones and washing machines. Officials in Henan and Hubei must give priority to local suppliers of buses, cars, farming equipment, software and medicines. In the province of Anhui, publicly funded infrastructure projects must use Anhui-made steel, concrete, doors and windows, glass, wiring and electrical equipment. Appliance-makers and two carmakers based in the province, Chery and Jianghuai Automobile, must buy locally made steel. In return, state-owned businesses, taxi operators and government officials will buy their cars. From next month, power plants will also have to buy locally mined coal.

Similarly, in Changchun City, in the Jilian province, inspection fees for new vehicles made by First Auto Works (FAW), a local carmaker, are being waived, giving the company a price advantage over rivals. Government officials have been told to consider FAW vehicles first; farmers will get a 10% discount on locally made tractors. At least 50% of the equipment for officially sanctioned “large projects” must be bought locally, too.

Such policies carry risks, especially in Asia. In Vietnam, Thailand and Malaysia exports account for more than 50% of the economy, and for more than one-third in Indonesia and China. Retaliatory barriers would hit these countries hard—hence the politicians’ public claims that they remain deeply opposed to protectionism. Yet halting its rise in Asia, as elsewhere, will be difficult. Most of the recent policy changes and buy-local pronouncements can be fudged under existing trade agreements. Politicians everywhere are torn between what they say in public about the evils of trade barriers—and the desire to protect special interests, taxes or votes at home.

Patriotic purchasing

Flying the flag

Mar 12th 2009 | SAN FRANCISCO
From The Economist print edition

A start-up aims to profit from patriotism

REGGIE CHARLES, the chief executive of High Society Freeride, a maker of skis and snowboards based in Colorado, is keen to wrap his firm's products in the Stars and Stripes. He is convinced that American customers will be more willing to buy the company's relatively costly gear when they discover that it is made in America with largely local materials.

Bryan Aldridge is betting that the recession will encourage more bosses to think like Mr Charles. He and a partner have just kicked off a new venture, My American Jobs, which plans to create a certification process to help customers identify products in which most of the materials and labour were sourced in America. The firm's website will list the goods that it certifies, their manufacturers and the retailers that stock them.

Stressing a product's origin to boost its sales is not exactly new. The Federal Trade Commission has long offered a process that allows goods that meet its criteria to carry a "Made in America" label. But Mr Aldridge reckons economic turmoil has created a chance for private initiatives to drum up much more interest in patriotic purchasing—and to profit from it, too.

His firm offers a rating of three, four or five stars for products, depending on the share of American-sourced raw materials used to make them, and whether or not they are assembled in America. The initial cost of certifying an individual product for a year is $2,250-5,500, depending on the company's profits. Norbert Kozar, the boss of an engineering firm based in Silicon Valley that is considering certification, says he is willing to splash out on the process because it will help emphasise just how innovative American manufacturers can be.

My American Jobs Inc

Is that a bit like Fairtrade, then?

My American Jobs claims its sliding scale even reflects the reality of globalisation. To get the three-star rating an applicant need only demonstrate that over half of the materials used in a product are from America; the product itself can be made anywhere in the world. (For five stars, more than 95% of the materials must come from America and the product has to be assembled there.) Yet some of the firm's promotional material smacks of chauvinism. "When you purchase a foreign-made hammer you employ 20 foreign workers," trumpets a recent press release. "When you buy a hammer made in America with American-made components you employ 20 of your family, friends, neighbours and fellow countrymen."

Nailing down enough manufacturers to make the business worthwhile will be difficult. Many firms will pay for certification only if they are sure that it influences what consumers buy. But My American Jobs has yet to run a marketing campaign to familiarise buyers with its insignia; there is no point, if no such goods are available yet. Moreover, as household budgets are squeezed, Americans may worry more about what things cost than where they come from. A flagging economy may actually hinder efforts to get consumers to buy the flag.

Continental and Schaeffler

Losing its bearings

Mar 12th 2009 | BERLIN
From The Economist print edition

An over-optimistic takeover falls victim to the recession

IT SEEMED to be the coup of the decade when Schaeffler, a family-owned German firm that makes bearings, triumphed in the hostile takeover of Continental, a car-parts firm three times its size. Schaeffler had not only displayed great stealth and cunning in sealing the deal. It also relied almost entirely on borrowed money, pulling itself up by its own bootstraps, as it were, to create one of the world's biggest car-parts suppliers. Now, however, a conquest that stunned corporate Germany last year for its audacity looks almost certain to end in humiliation.

Few have ever doubted the underlying logic of Schaeffler's €12 billion ($17.9 billion) bid for Continental. It promised to combine two highly complementary businesses in an industry undergoing rapid consolidation. One firm, for instance, made fuel injectors; the other specialised in the software to control them. And with the world economy and commodity markets still booming, Continental's tyre business alone was thought to be so valuable that, if it were sold, the proceeds could pay down a significant portion of the debt Schaeffler had raised to buy it.

Schaeffler's big mistake, however, was to structure a bid so Panglossian that it could have failed in any number of ways, almost all of which have now come to pass. The company's first problem was that it was more successful than it wanted to be. Its too-clever-by-half takeover had been finely tuned to gain it just a little less than 50% of Continental. To do that Schaeffler used derivatives and bought shares on the sly to build up, in effect, a secret 36% stake in Continental before launching its takeover attempt.

But its first offer for the shares was so low that it was rejected by Continental's board. Although the offer was later raised just enough to win consent, Schaeffler promised not to control more than half of the resulting firm. Schaeffler's misfortune, however, was that its offer closed just after the collapse of Lehman Brothers sent markets into a spin, spurring almost all of Continental's shareholders to accept its bid. Instead of buying just half of Continental for about €6 billion, Schaeffler ended up buying almost all of it.

Its second problem was the way it structured its debt by relying on borrowing from banks, rather than selling bonds with long maturities. A privately owned company, Schaeffler does not say much about its finances or its borrowings. But people familiar with the firm reckon it could have pulled off the deal had it been able to limit itself to buying half of Continental. One insider says Schaeffler's cash generation would have easily sufficed to shoulder the debt burden it would have needed to finance a 50% stake. But now it is struggling to finance borrowings estimated to have swollen to as much as €11 billion, more than twice what the firm is thought to have planned on when it first launched the bid.

That Continental itself is swollen with debt only compounds Schaeffler's problems. Two years ago the tyremaker paid €11 billion for VDO, a specialist in car electronics. Its bankers are also knocking at the door. In January they forced Continental to trim its dividends and use the cash to service debt. And in February Moody's cut its rating on the firm's debt.

Because of their debt, both firms are vulnerable to slowing demand. One measure of Continental's troubles emerged on March 11th, when it said it was shutting plants in Germany and France and cutting back elsewhere. Its sales of truck and car tyres, having fallen 20% in the last three months of 2008, fell again by as much as 30% in the first two months of 2009.

Schaeffler has asked the German government for a bail-out, saying that without bridging finance it may collapse or be broken up, taking thousands of jobs and two national champions with it. Yet its pleading is not finding a sympathetic ear, partly because the harm from a collapse of this deal would probably be contained. Continental itself would feel few ill effects from the collapse of its now-biggest shareholder, because the two firms' financing and operations are not yet integrated.

And Schaeffler's profitable operating businesses would probably find another home soon—perhaps even

inside Continental if they were going cheaply enough. The primary victims of Schaeffler's collapse would be the family that controls it, the banks that financed it and the blind optimism that encouraged them to embark on a deal that could have prospered only in the best of all possible worlds.

Marketing to women

Hello, girls

Mar 12th 2009
From The Economist print edition

Recession-hit companies target female customers

Illustration by David Simonds

NEVER mind the fight to get people to open their wallets in the recession—some companies are taking a different tack, and trying to get customers to open their purses instead. In America, where female consumers make more than 80% of discretionary purchases, companies have started tailoring their products and messages to appeal to women, in an effort to boost their sales.

Frito-Lay, a snack-food company owned by PepsiCo, has launched a campaign called "Only In A Woman's World" to convince women that crisps and popcorn are not just for male, beer-guzzling sport fans. OfficeMax, America's second-largest office-supplies company, has redesigned its notebooks and file-holders to appeal to women and has run advertisements that encourage women to make their cubicles more colourful. For the first time, McDonald's was a sponsor of New York Fashion Week in February, promoting a new line of hot drinks to trendsetting women.

Eric Almquist, head of global consumer insights for Bain & Company, a consultancy, says he is surprised it has taken a recession to get companies to focus on women. After all, it is hardly news that they control the vast majority of consumer spending. (They buy 90% of food, 55% of consumer electronics, and most of the new cars.) But the recession has prompted companies to rethink their approach. SheSpeaks, a marketing consultancy that helps companies including Citibank and Philips reach women consumers, has tripled its number of clients since the recession began. Some women's magazines, too, are benefiting as companies that had never before expressed interest in advertising with them are now doing so.

Aside from their greater purchasing clout, women are valuable customers for three reasons. First, they are loyal, says Marti Barletta, author of "Marketing to Women", and more likely to continue to buy a brand if they like it. Second, women are more likely than men to spread information about products they like through word of mouth and social-networking sites. Third, most of the lay-offs so far in America have been in male-dominated fields, like manufacturing and construction. This means women may bring home a greater share of household income in the months ahead and have even more buying power.

But marketing to women may not work for every company. In particular, for firms (such as some carmakers) with brands that are regarded as strongly male, "gender bending", or trying to attract the opposite sex, could enhance short-term sales but cause a longer-term decline. Jill Avery of the Simmons School of Management in Boston researched this trend with cars. When Porsche released a sport-utility vehicle designed for women, sales temporarily increased, but men started to move away from the brand, on the basis that it had compromised its masculine image. But in this recession, having a tarnished brand is better than having no brand at all.

Face value

The long and the short

Mar 12th 2009
From The Economist print edition

John Paulson made a fortune betting against mortgages. Now he spies opportunities in the wreckage

Bloomberg

IN TODAY'S gut-wrenching markets, winners are as rare as a house that sells for the asking price. Even Warren Buffett is looking less than sagacious after his holding company posted its worst year ever. But one investor who continues to win plaudits is John Paulson. His hedge funds have had a superb crisis. They clocked up triple-digit returns in 2007 betting against subprime mortgages, netting him $3.7 billion personally—a sum that made George Soros's winnings from currency bets in the early 1990s look modest. Mr Paulson's funds continued to do well last year, rising by 7.9-37.6% even as those run by other hedge-fund titans, such as SAC's Steve Cohen and Citadel's Ken Griffin, suffered miserably. His funds were all up again in the first two months of 2009, and they now hold $30 billion—a war chest that Mr Paulson is now starting to use to gobble up the very securities that made him rich when they collapsed in value.

He cut his teeth in risk arbitrage, which involves punting on actual or potential merger targets. This remains an important strategy for him, and he had reason to celebrate this week when Dow Chemical agreed (under legal pressure) to complete its $15.3 billion acquisition of Rohm & Haas, another chemicals firm, in which Mr Paulson's funds own a big stake. But he is best known for his canny bets against mortgage-backed bonds and financial shares. The firms in which he was "short" (ie, betting on a fall) last year lost, on average, 90% of their value.

Success has not bred arrogance. On the contrary, Mr Paulson is a fitting icon for the post-boom age: mild-mannered, bordering on weedy and so soft-spoken that when testifying before Congress in November he had to be asked to speak up. His first taste of business was to buy sweets in bulk and sell them to classmates at a hefty mark-up, but it is hard to imagine him having had the guts for such a scheme. He has never charged more than 1½% of assets and 20% of profits, a reasonably modest fee for a hedge-fund superstar. His job is, he says, more about preserving clients' principal than gambling for outsized returns.

Accordingly, his funds generally eschew leverage, or making bets with borrowed money. He insists that his fruitful subprime trade, far from being stunningly clever, was a no-brainer for anyone who bothered to analyse the complex securities' underlying collateral. "It was obvious that a lot of the stuff…was practically worthless at the time of issuance," he says. He finds it "perplexing" that the banks holding the higher-rated tranches could not see this danger, and that so few others were prepared to believe that Wall Street's finest could have miscalculated so badly.

Another motivating factor for Mr Paulson was the alluring asymmetry of shorting credit. The most you can lose is the spread over some benchmark rate. Yet if the bond defaults, the gains can be mouth-watering. He targeted BBB-rated tranches, the lowest in subprime securities. With credit spreads so low because of a liquidity glut, his possible upside as a buyer of protection using credit-default swaps (CDSs) was as much as hundred times the potential downside. One $22m trade is said to have netted him $1 billion when Lehman Brothers went bust. Though the CDS market has been good to him, he believes it "blew out of control" and needs to be regulated and moved onto exchanges, with margin requirements to limit excessive speculation. He also advocates tighter oversight of hedge funds.

He is, however, robust in his defence of short-selling, which has been vilified for its perceived role in driving down banks' share prices. He sees it as a "valuable" tool, used not least by banks themselves to hedge their various exposures. More importantly, he argues, it is too small a part of stockmarket activity to move prices. His shorting "made absolutely no difference to the performance of any mortgages, securities or banks." The blame lies with reckless lending, not with those who capitalise on the resulting mispricing of securities. There is, therefore, no "moral dimension"—though he allows that some of the "more vocal" shorts may have hurt banks' prospects of raising fresh capital.

Still, his vast profits make him a target in a world where high finance is held in low esteem. *Portfolio*, a business magazine, dubbed him "The man who made too much". He retorts that the bulk of the profits went to his investors, which include foundations, endowments and pension funds. They are not the only ones with reason to thank him: a $15m donation is helping families facing foreclosure to keep their homes, by paying for lawyers to exploit the sloppy documentation that accompanied the often-hurried pooling of subprime mortgages into securities. Mr Paulson says he has many other philanthropic arrows in his quiver, but to publicise them would "take away the altruism".

Distress call

Just as markets used to hang on Mr Soros's every move, they are now keen followers of Mr Paulson. He does not see the economy reaching bottom this year and is still a net short-seller of financial firms. More encouragingly, he has started buying up bombed-out mortgage securities. The number-crunching that told him subprime-linked paper was overvalued now suggests that some previously AAA-rated tranches are a bargain. He talks of distressed debt—mortgages, leveraged loans and the debt of bankrupt firms—as a $10 trillion opportunity.

At some point, his "number-one focus" will be to provide equity to recapitalise sick but viable banks. He is already dipping his toe in: his latest vehicle, the Recovery Fund, recently took a 25% stake in IndyMac, a Californian bank that the government seized last July. But the timing of any bigger push is uncertain. Mr Paulson is acutely aware of the costs of moving too early: those who have bought into financial firms since the start of the crisis have lost, on average, 80% of their investment. Still, in these dire times it is comforting to know that such a smart investor believes there will be something worth saving.

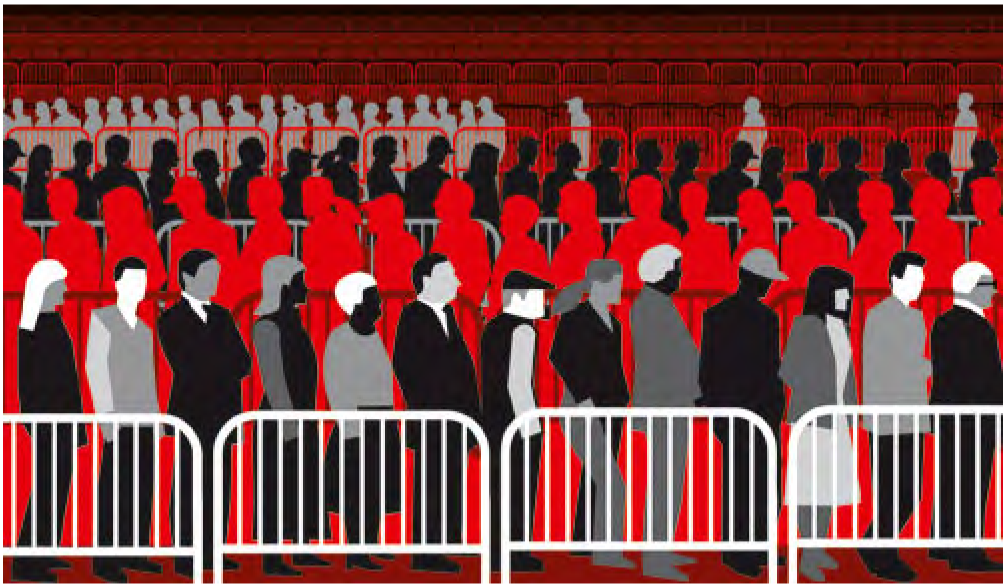
Unemployment

When jobs disappear

Mar 12th 2009 | LONDON, TOKYO AND WASHINGTON, DC
From The Economist print edition

The world economy faces the biggest rise in unemployment in decades. How governments react will shape labour markets for years to come

Illustration by Dettmer Otto



LAST month America's unemployment rate climbed to 8.1%, the highest in a quarter of a century. For those newly out of a job, the chances of finding another soon are the worst since records began 50 years ago. In China 20m migrant workers (maybe 3% of the labour force) have been laid off. Cambodia's textile industry, its main source of exports, has cut one worker in ten. In Spain the building bust has pushed the jobless rate up by two-thirds in a year, to 14.8% in January. And in Japan, where official unemployment used to be all but unknown, tens of thousands of people on temporary contracts are losing not just their jobs but also the housing provided by their employers.

The next phase of the world's economic downturn is taking shape: a global jobs crisis. Its contours are only just becoming clear, but the severity, breadth and likely length of the recession, together with changes in the structure of labour markets in both rich and emerging economies, suggest the world is about to undergo its biggest increase in unemployment for decades.

In the last three months of 2008 America's GDP slumped at an annualised rate of 6.2%. This quarter may not be much better. Output has shrunk even faster in countries dependent on exports (such as Germany, Japan and several emerging Asian economies) or foreign finance (notably central and eastern Europe). The IMF said this week that global output will probably fall for the first time since the second world war. The World Bank expects the fastest contraction of trade since the Depression.

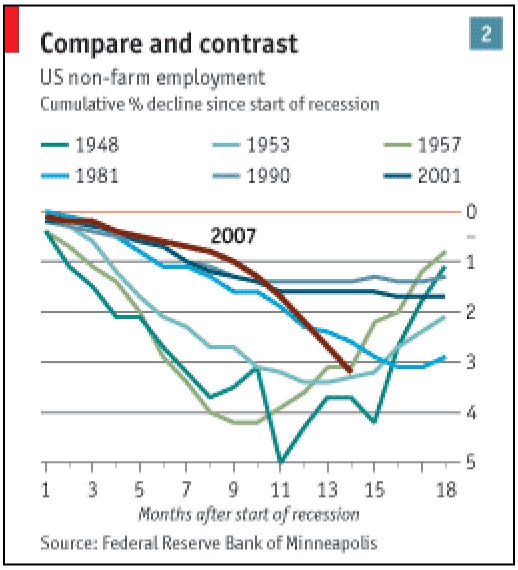
An economic collapse on this scale is bound to hit jobs hard. In its latest quarterly survey Manpower, an employment-services firm, finds that in 23 of the 33 countries it covers, companies' hiring intentions are the weakest on record (see chart 1). Because changes in unemployment lag behind those in output, jobless rates would rise further even if economies stopped contracting today. But there is little hope of that. And several features of this recession look especially harmful.

The credit crunch has exacerbated the impact of falling demand, pressing cash-strapped firms to cut costs more quickly. The asset bust and unwinding of debt that lie behind the recession mean that eventual recovery is likely to be too weak to create jobs

rapidly. And when demand does revive, the composition of jobs will change. In a post-bubble world indebted consumers will save more and surplus economies, from China to Germany, will have to rely more on domestic spending. The booming industries of recent years, from construction to finance, will not bounce back. Millions of people, from Wall Street bankers to Chinese migrants, will need to find wholly different lines of work.

For now the damage is most obvious in America, where the recession began earlier than elsewhere (in December 2007, according to the National Bureau of Economic Research) and where the ease of hiring and firing means changes in the demand for workers show up quickly in employment rolls. The economy began to lose jobs in January 2008. At first the decline was fairly modest and largely confined to construction (thanks to the housing bust) and manufacturing (where employment has long been in decline). But since September it has accelerated and broadened. Of the 4.4m jobs lost since the recession began, 3.3m have gone in the past six months. Virtually every sector has been hit hard. Only education, government and health care added workers last month.

So far, the pattern of job losses in this recession resembles that of the early post-war downturns (starting in 1948, 1953 and 1957). Those recessions brought huge, but temporary, swings in employment, in an economy far more reliant on manufacturing than today's. As a share of the workforce, more jobs have been lost in this recession than in any since 1957. The pace at which people are losing their jobs, measured by the share of the workforce filing for weekly jobless claims, is much quicker than in the downturns of 1990 and 2001 (see chart 2).



The worry, however, is that the hangover from excess debt and the housing bust will mean a slow revival—looking more like the jobless recoveries after the past two downturns than like the vigorous V-shaped rebounds from the early post-war recessions. Ominous signs are a sharp increase in permanent-job losses and a rise in the number of people out of work for six months or more to 1.9% of the labour force, near a post-war high.

Official forecasts can barely keep up. In its budget in February the Obama administration expected a jobless rate of 8.1% for the year. That figure was reached within the month. Many Wall Street seers think the rate will exceed 10% by 2010 and may surpass the post-1945 peak of 10.8%. Past banking crises indicate an even gloomier prognosis. A study by Carmen Reinhart of the University of Maryland and Ken Rogoff of Harvard University suggests that the unemployment rate rose by an average of seven percentage points after other big post-war banking busts. That implies a rate for America of around 12%.

Moreover, the official jobless rate understates the amount of slack by more than in previous downturns. Many companies are cutting hours to reduce costs. At 33.3 hours, the average working week is the shortest since at least 1964. Unpaid leave is becoming more common, and not only at the cyclical manufacturing firms where it is established practice. A recent survey by Watson Wyatt, a firm of consultants, finds that almost one employer in ten intends to shorten the work week in coming months. Compulsory unpaid leave is planned by 6% of firms. Another 9% will have voluntary leave.

Europe's jobs markets look less dire, for now. That is partly because the recession began later there, partly because joblessness had been unusually low by European standards and partly because Europe's less flexible labour markets react more slowly than America's. The euro area's unemployment rate was 8.2% in January, up from 7.2% a year before. That of the whole European Union was 7.6%, up from 6.8%. For the first time in years American and European jobless rates are roughly in line (see chart 3).

Within the EU there are big variations. Ireland and Spain, where construction boomed and then subsided most dramatically, have already seen heavy job losses. Almost 30% of Ireland's job

growth in the first half of this decade came from the building trade. Its unemployment rate has almost doubled in the past year. In Britain, another post-property-bubble economy, the rate is also rising markedly. At the end of last year 6.3% of workers were jobless, up from 5.2% the year before. Figures due on March 18th are likely to show unemployment above 2m for the first time in more than a decade.

In continental Europe's biggest economies, the consequences for jobs of shrivelling output are only just becoming visible. Although output in Germany fell at an annualised rate of 7% in the last quarter of 2008, unemployment has been only inching up. The rate is still lower than it was a year ago. Even so, no one doubts the direction in which joblessness is heading. In January the European Commission forecast the EU's jobless rate to rise to 9.5% in 2010. As in America, many private-sector economists expect 10% or more.

Structural changes in Europe's labour markets suggest that jobs will go faster than in previous downturns. Temporary contracts have proliferated in many countries, as a way around the expense and difficulty of firing permanent workers. Much of the reduction in European unemployment earlier this decade was due to the rapid growth of these contracts. Now the process is going into reverse. In Spain, Europe's most extreme example of a "dual" labour market, all the job loss of the past year has been borne by temps. In France employment on temporary contracts has fallen by a fifth. Permanent jobs have so far been barely touched.

Although the profusion of temporary contracts has brought greater flexibility, it has laid the burden of adjustment disproportionately on the low-skilled, the young and immigrants. The rising share of immigrants in Europe's workforce also makes the likely path of unemployment less certain. As Samuel Bentolila, an economist at CEMFI, a Spanish graduate school, points out, the jump in Spain's jobless rate is not due to fewer jobs alone. Thanks to continued immigration, the labour force is still growing apace. In Britain, in contrast, hundreds of thousands of migrant Polish workers are reckoned to have gone home.

Despite having few immigrants, Japan is also showing the strains of a dual labour market. Indeed, its workforce is more starkly divided than that of any other industrial country. "Regular" workers enjoy strong protection; the floating army of temporary, contract and part-time staff have almost none. Since the 1990s, the "lost decade", firms have relied increasingly on these irregulars, who now account for one-third of all workers, up from 20% in 1990.

As Japanese industry has collapsed, almost all the jobs shed have been theirs. Most are ineligible for unemployment assistance. A labour-ministry official estimates that a third of the 160,000 who have lost work in recent months have lost their homes as well, sometimes with only a few days' notice. Earlier this year several hundred homeless temporary workers set up a tent village in Hibiya Park in central Tokyo, across from the labour ministry and a few blocks from the Imperial Palace. Worse lies ahead. Overall unemployment, now 4.1%, is widely expected to surpass the post-war peak of 5.8% within the year. In Japan too, some economists talk of double digits.

In emerging economies the scale of the problem is much harder to gauge. Anecdotal evidence abounds of falling employment, particularly in construction, mining and export-oriented manufacturing. But official figures on both job losses and unemployment rates are squishier. Estimates from the International Labour Organisation suggest the number of people unemployed in emerging economies rose by 8m in 2008 to 158m, an overall jobless rate of around 5.9%. In a recent report the ILO projected several scenarios for 2009. Its gloomiest suggested there could be an additional 32m jobless in the emerging world this year. That estimate now seems all too plausible. Millions will return from formal employment to the informal sector and from cities to rural areas. According to the World Bank, another 53m people will be pushed into extreme poverty in 2009.

History implies that high unemployment is not just an economic problem but also a political tinderbox. Weak labour markets risk fanning xenophobia, particularly in Europe, where this is the first downturn since immigration soared. China's leadership is terrified by the prospect of social unrest from rising joblessness, particularly among the urban elite.

Given these dangers, politicians will not sit still as jobs disappear. Their most important defence is to boost demand. All the main rich economies and most big emerging ones have announced fiscal stimulus packages.

Since most emerging economies lack broad unemployment insurance, the main way they help the jobless is through labour-intensive government infrastructure projects as well as conditional cash transfers for the poorest. China's fiscal boost includes plenty of money for infrastructure; India is accelerating projects worth 0.7% of GDP. However, a few emerging economies have more creative unemployment-insurance schemes than anything in the rich world. In Chile and Colombia formal-sector workers pay into individual unemployment accounts, on which they can draw if they lose their jobs. Many more countries have created prefunded pension systems based on individual accounts. Robert Holzmann of the World Bank thinks people should be allowed to borrow from such accounts while unemployed. Several countries are considering the idea.

In developed countries, governments' past responses to high unemployment have had lasting and sometimes harmful effects. When joblessness rose after the 1970s oil shocks, Europe's governments, pressed by strong trade unions, kept labour markets rigid and tried to cut dole queues by encouraging early retirement. Coupled with generous welfare benefits this resulted in decades of high "structural" unemployment and a huge rise in the share of people without work. In America, where the social safety net was flimsier, there were far fewer regulatory rigidities and people were more willing to move, so workers responded more flexibly to structural shifts. Less than six years after hitting 10.8%, the post-war record, in 1982, America's jobless rate was close to 5%.

Illustration by Dettmer Otto

Policy in America still leans towards keeping benefits low and markets flexible rather than easing the pain of unemployment. Benefits for the jobless are, if anything, skimpier than in the 1970s. Unemployment insurance is funded jointly by states and the federal government. The states set the eligibility criteria and in many cases have not kept up with changes in the composition of the workforce. In 32 states, for instance, part-time workers are ineligible for benefits. All told, fewer than half of America's unemployed receive assistance. The benefits they get also vary a lot from state to state, but overall are among the lowest in the OECD when compared with the average wage.

America's recent stimulus package strengthened this safety net. Jobless benefits have increased modestly, their maximum duration has been extended, and states have been given a large financial incentive to broaden eligibility. The package also includes temporary subsidies to help pay for laid-off workers' health insurance. Even so, benefits remain meagre.

Housing is a far bigger drag on American job mobility. Almost a fifth of American households with mortgages owe more than their house is worth, and house prices are set to fall further. "Negative equity" can lock in homeowners, making it hard to move to a new job. A recent study suggests that homeowners with negative equity are 50% less mobile than others.

Europe's governments, at least so far, are trying hard to avoid the mistakes of the 1970s and 1980s. As Stefano Scarpetta of the OECD points out, today's policies are designed to keep people working rather than to encourage them to leave the labour force. Several countries, from Spain to Sweden, have temporarily cut social insurance contributions to reduce labour costs.

A broader group including Austria, Denmark, France, Germany, Hungary, Italy and Spain, are encouraging firms to shorten work weeks rather than lay people off, by topping up the pay of workers on short hours. Germany, for instance, has long had a scheme that covers 60% of the gap between shorter hours and a full-time wage for up to six months. The government recently simplified the required paperwork, cut social-insurance contributions for affected workers, and extended the scheme's maximum length to 18 months.

Britain has taken a different tack. Rather than intervening to keep people in their existing jobs, it has focused on deterring long-term joblessness with a package of subsidies to encourage employers to hire, and train, people who have been out of work for more than six months.

Of all rich-country governments, Japan’s has flailed the most. Forced to confront the ugly reality of its labour market, it is trying a mixture of policies. Last year it proposed tax incentives for companies to turn temps into regular employees—a futile effort when profits are scarce and jobs being slashed. The agriculture ministry suggested sending the jobless to the hinterland to work on farms and fisheries. As Naohiro Yashiro, an economist at the International Christian University in Tokyo, puts it: “Although temporary and part-time workers are everywhere in Japan, they are thought to be a threat to employment practices and—like terrorists—have to be contained.”

Recently, a more ambitious strategy has emerged. The government is considering shortening the minimum work period for eligibility to jobless benefits. It is providing newly laid-off workers with six-month loans for housing and living expenses. It is paying small-business owners to allow fired staff to remain in company dorms. It is subsidising the salaries of workers on mandatory leave. It is paying firms for rehiring laid-off staff, and offering grants to anyone willing to start a new business.

Whether these policies will be enough depends on how the downturn progresses. For by and large they are sticking-plasters, applied in the hope that the recession will soon be over and the industrial restructuring that follows will be modest. Subsidising shorter working weeks, for instance, props up demand today, but impedes long-term reordering. The inequities of a dual labour market will become more glaring the higher unemployment rises. Politicians seem to be hoping for the best. Given the speed at which their economies are deteriorating, they would do better to plan for the worst.

The G20

Talking-shop-on-Thames

Mar 12th 2009 | BERLIN, LONDON AND WASHINGTON, DC
From The Economist print edition

Illustration by S. Kambayashi

Transatlantic tensions suggest that there will be no grand bargain at next month's grand summit

"LIKE King Charles II, the Economic Conference is taking an unconscionable time to die," lamented *The Economist* in 1933, halfway through an epic—and ultimately fruitless—gathering of world powers in London to prevent the spread of protectionism in the depths of the Depression. That conference lasted more than a month, with the dollar sinking and tempers rising the longer it dragged on.

At least there is no danger of interminable drift when leaders of the Group of 20 gather in London next month to address the worst economic crisis since the 1930s. They have set themselves just one day, April 2nd, to do what their predecessors failed to accomplish in weeks: tackle the crisis and consider ways to remake the rules of finance. This weekend G20 finance ministers and central bank governors attending a preparatory meeting in London may well attempt to limit expectations. More pressingly, they will have to heal an awkward sense of transatlantic disunity that has emerged in the run-up to the meeting.

The tensions were exposed at an assembly of European finance ministers on March 9th and 10th. The ministers responded sharply to a call by Lawrence Summers, the White House economic adviser, for everyone in the G20 to focus on boosting global demand. Such calls were "not to our liking," sniped Jean-Claude Juncker, Luxembourg's prime minister and the chairman of the meeting. The cause of harmony may not have been helped when Britain's most senior civil servant was quoted as saying the shortage of staff in Barack Obama's two-month-old Treasury was making preparations for the summit "unbelievably difficult". (Tim Geithner, the treasury secretary, disputes that.)

In reality, the tensions appeared more symptomatic of the opening of bargaining than of a disastrous rift. The G20's agenda focuses on three broad areas: sorting out the crisis through fiscal and monetary means and by encouraging banks to lend; medium-term regulatory reforms; and strengthening multilateral bodies such as the IMF so that they can give more help to crisis-hit developing countries. Everyone has different priorities.

America feels its counterparts are not doing enough to boost demand. It would like them to pledge a fiscal stimulus equal to 2%

of global GDP this year and next, and for the IMF to monitor compliance. Some countries would also like the European Central Bank to make better use of its monetary arsenal, as the Federal Reserve and the Bank of England have. America has indeed done a lot to stimulate growth (see table). The IMF, however, notes that taking into account automatic stabilisers, such as welfare payments to the unemployed, Germany's fiscal response is not as far behind America's as it appears. Not only does Germany feel its spending package is big enough, it is pressing for a quick return to balanced budgets when the crisis is over.

Let's get fiscal

Stimulus packages as % of GDP

	2008	2009	2010	Total*
Canada	0.0	1.5	1.3	**2.7**
France	0.0	0.7	0.7	**1.3**
Germany	0.0	1.5	2.0	**3.4**
India	0.0	0.5	–	**0.5**
Italy	0.0	0.2	0.1	**0.3**
Japan	0.4	1.4	0.4	**2.2**
Britain	0.2	1.4	-0.1	**1.5**
United States	1.1	2.0	1.8	**4.8**

Source: IMF estimates *Subject to rounding

Although transatlantic differences have emerged over fiscal policy, they are narrowing over regulation. Germany and France have long battled to persuade America and Britain to regulate hedge funds, which are clustered in the financial centres of New York and London. America is now prepared to countenance regulation of systemically important ones.

Since the G20 leaders first met in November, their deputies have laboured on reforms to the stricken global financial system, in particular through the Financial Stability Forum (FSF), a Basel-based group that met in London this week. These include reforms that would affect bank regulators, supervisors and accounting standard-setters, and cover bankers' pay, derivatives trading and rating agencies. America, chastened by its own regulatory failures, is now more supportive of tougher, co-ordinated global regulatory standards but only to a degree: it is unenthusiastic about uniform standards for executive pay pushed by Britain.

In addition, the FSF is expected to propose to the G20 ways to make bank regulation less pro-cyclical, by making forward-looking provisions against bad loans rather than the "incurred-loss" method now in use—though not so that banks can use the provisions to massage earnings (see article). It will suggest incorporating a leverage ratio into bank-capital requirements, to supplement the existing risk-weighting of assets. It is also helping set up cross-border supervisory colleges to share information about 30 global banks.

Illustration by S. Kambayashi

There is general support for doubling the IMF's resources to $500 billion, but America would like it to have even more. It is not clear how the increase would be funded. Reserve-rich countries like China could contribute more, as Japan did with a $100 billion pledge in February. But some fear that strings might be attached to such money, such as less criticism of China's exchange-rate policy. Mr Geithner has proposed the IMF's credit line with 26 rich member countries be dramatically raised to $500 billion from $50 billion.

Some of the trade-offs will be driven by political considerations. French and German voters, for example, lay part of the blame for the crisis on hedge funds and tax havens, even though both played minor roles compared with the highly regulated banking system. Likewise, Mr Geithner is pressing for higher global capital standards for non-bank financial firms (such as American International Group, a big insurer), in part to reassure taxpayers that this sort of crisis and the accompanying bail-outs will not be repeated.

Given the importance of the summit to the reputations of Gordon Brown, its British host, and Mr Obama, on his first overseas trip since taking office, every effort will be made to trumpet such progress. Few expect a 1933-style fiasco, though participants believe that given the tensions exhibited this week, a narrowing of differences is more likely than any "grand bargain" to put the world to rights.

The best that might emerge from the summit is proof that leaders of the world's biggest economies continue to talk to each other. Given the urgency of the situation, and the immense capital that Mr Obama still holds abroad, the world might have hoped for more. Talk, like so much else in this financial crisis, is cheap.

Regulating banks

Inadequate

Mar 12th 2009
From The Economist print edition

A spat looms over reforming bank capital-adequacy rules

SOMETIMES the only thing people can agree on is a mediocre idea. Ahead of the G20 meeting, some regulators are pushing to introduce dynamic provisioning for banks. Under this system, in boom years banks make provisions against profits which then sit on their balance-sheets as reserves against unspecified potential losses. In the bad years they draw down on these reserves. This smooths banks' profits over the cycle, making their capital positions "counter-cyclical". Supporters point to Spain, which uses this approach and whose lenders are in relatively good nick.

Banks should be encouraged to save more for a rainy day. But the importance of Spain's system has been oversold. Going into the credit crisis, its two big banks had an extra buffer equivalent to about 1.5% of risk-weighted assets. Banks like UBS or Citigroup have had write-offs far beyond this, equivalent to 8-15% of risk-weighted assets. Whether dynamic provisions influenced managers' behaviour is also questionable. Spain's BBVA was run using an economic-capital model that, according to its 2007 annual report, explicitly replaced the generic provision in its income statement with its "best estimate of the real risk incurred".

Accounting standard-setters, meanwhile, are not amused. They support the objective of counter-cyclical capital rules but think dynamic provisioning is a bad way to achieve this. Why not simply require banks to run with higher capital ratios, rather than go through a circuitous route by smoothing profits, which investors tend to dislike? Accountants worry their standards are being fiddled with needlessly, after a decades-long fight to have them independently set to provide accurate data to investors.

Is there a solution? If anything, the crisis shows that accounting and supervision should be further separated to break the mechanistic link between mark-to-market losses and capital. Investors should get the information they want. Supervisors should make a judgment about the likelihood of losses and set the required capital level accordingly. Warren Buffett, an astute investor, has endorsed this approach.

Sadly, bank supervision is as dysfunctional as the banks. The Basel 2 accords took five years to negotiate. Local regulators interpreted them differently and many failed to enforce them. Confidence in their integrity is now so low that many investors and some banks and regulators have abandoned Basel as their main test of capital. Given this mess, it is easy to see why policymakers might view tweaking accounting standards as an attractive short cut: with some arm-twisting, the rules can be changed quickly and are legally enforceable. But this is a matter where short cuts are not good enough.

China's stimulus

Got a light?

Mar 12th 2009 | HONG KONG
From The Economist print edition

China's big fiscal package may be starting to work

"ONLY when all contribute their firewood can they build up a strong fire," says a Chinese proverb. With the world economy in its worst crisis in 70 years, every country needs to do its bit to rekindle global demand. The American government, which plans to run a budget deficit of 12% of GDP this year, has called on its Group of 20 partners to do more. Is China one of the misers? Its budget, published last week, showed that it plans to run a deficit of only 3% of GDP. Was the 4 trillion yuan ($586 billion) infrastructure package unveiled last November, worth 14% of GDP, a sham?

Beijing's stimulus is smaller than the number announced last year, but it is still the biggest in the world. The fact that America is set to run a budget deficit four times the size of China's as a share of GDP does not mean its demand stimulus is bigger; America started this year with a much bigger deficit. America's deficit will increase by more than China's this year, largely because it is suffering a deeper recession which will depress tax revenue. The correct measure of a fiscal stimulus is the change in the budget deficit adjusted for the impact of the economic cycle.

In China, however, even this would understate the true stimulus, because some public-infrastructure investment will be done by state-owned firms or local governments and financed by banks. Tao Wang of UBS estimates that new infrastructure investment, tax cuts, consumer subsidies and increased spending on health care will amount to a stimulus by the central government of about 3% of GDP in 2009. Adding in bank-financed infrastructure spending might lift the total to 4% of GDP.

Chinese investment in railways, roads and power grids is already booming. In the first two months of this year, total fixed investment was 30% higher in real terms than a year earlier, and investment in railways tripled. China has been much criticised for focusing its stimulus on investment, rather than consumption, but in China in the short term this is the quickest way to boost domestic demand.

What about the other tool for boosting domestic spending, namely monetary policy? Since the start of last year, China has cut its interest rates by only half as much as America's Federal Reserve has. New figures showing that consumer prices fell by 1.6% in the year to February have brought the first whiff of deflation, suggesting that China has not done enough to boost demand. But this is not true deflation, where falling prices are accompanied by shrinking money supply and credit. Bank lending grew by 24% over the past year. The true gauge of monetary easing is not the cut in interest rates, but whether it succeeds in spurring new lending. China is one of the few countries in the world where credit has accelerated since the start of the global credit crunch—though some of the lending is of the state-directed sort.

China has not only accomplished considerable fiscal and monetary easing. By allowing the yuan to rise by 18% in trade-weighted terms over the past 12 months, Beijing is passing on some of that boost to the rest of the world.

The real question is whether China's stimulus is big enough? Exports fell by a sharper-than-expected 26% in the year to February and may yet drop further. The 12-month rate of growth in industrial production also dropped to only 3.8% in the first two months of 2009, and retail-sales growth slowed to 15%. But there are some tentative signs of a recovery in domestic demand. As well as the increases in investment and bank lending, car sales and electricity consumption have picked up. Mingchun Sun of Nomura reckons that the stimulus will be enough to achieve 8% growth this year. But the government has made it clear that if the economy remains feeble, it will supply another fiscal boost.

Such injections may be able to drag growth back to 8% this year, but they cannot keep the economy running at this pace if global demand remains depressed. The need for China to shift the mix of growth from exports to consumption has become more urgent. Chinese officials are right to say that it will take years for higher public spending on health care and a social safety net to reduce household saving—all the

more reason to speed up such policies. If not, even China’s fire could burn out.

Economist.com FINANCE & ECONOMICS

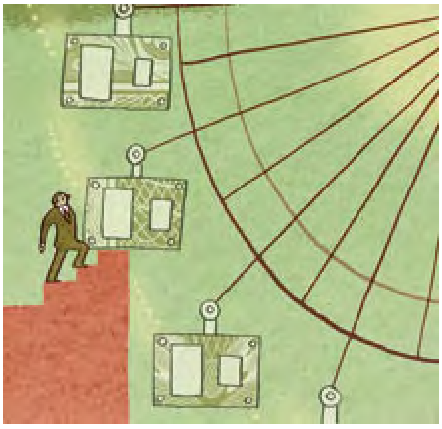
Buttonwood

The bear necessities

Mar 12th 2009
From The Economist print edition

The market may have been terrible but investors' odds are improving

Illustration by S. Kambayashi



HURRICANES, volcanic eruptions and tornadoes have a savage beauty that takes the breath away, even as one laments their destructive power. And bear markets can also be awe-inspiring in their scale and scope.

There has been no hiding place for equity investors. Standard & Poor's points out that all the major bourses are at least 50% below their peaks. Most of them are 60% down. It has been no use buying smaller stocks, or value stocks (those that look cheap in terms of earnings, assets or dividends); all have fallen by a similar amount. Diversification has been a washout: stockmarkets have been almost perfectly correlated with each other.

Rob Arnott, the former editor of the *Financial Analysts Journal*, says that the S&P 500's decline in the six months to March 6th was the fastest since 1932. The fall in real terms from the high of 2000 has been exceeded only three times: in 1852-57, 1905-21 and 1929-32.

There are striking similarities between the downturns. Bear phases are generally preceded by great booms: the railroad mania of the mid-19th century, the Roaring Twenties, and the internet bubble. The early 20th-century bear market came after stockmarket valuations reached a new peak, as measured by the cyclically adjusted price-earnings ratio (which averages profits over ten years). In his book "Irrational Exuberance", Robert Shiller of Yale University notes how the era was marked by "a turn-of-the-century optimism associated with expansion talk about a prosperous and high-tech future."

As Charles Kindleberger recounted in his classic book "Manias, Panics and Crashes", the busts tend to be accompanied by great swindles, from Robert Schuyler in the 1850s to Ivar Kreuger in the 1930s. Bernard Madoff looks destined to be today's swindler-in-chief (see article). The result has often been financial reform—the prime examples are the introduction of the Federal Reserve in 1913 and the founding of the Securities and Exchange Commission in 1934.

For investors, bear markets crush the spirit. They are often marked by sharp rallies that seem to indicate the worst is over; the Nikkei 225 Average rose by 37% in 1999, for example, a decade into the Japanese bear market. But it was a false dawn. The Nikkei is now under half its end-1999 level.

The really big bear markets seem to take prices well below levels that investors would consider "cheap" in normal circumstances. In a way, it is a mirror of the "irrational exuberance" that occurred in the late 1990s. In Britain and America the dividend yield is now well above the yield on government bonds, something not seen since the 1950s.

But that has not helped the market at all, nor has the fact that investors can get a dividend income from equities (even allowing for the likelihood of reduced payouts) that is a multiple of the returns available from cash deposits. Return of capital has become more important than return on capital.

But it is possible for investors to take advantage of bear markets, even if they do not get their timing exactly right. Investors who bought American equities at the end of 1931, well before the market hit the bottom the next year, would have earned an annual real return of 6.9% over the following ten years. That is almost bang on the historic average.

In Britain those who bought equities at the end of 1973 suffered through the three-day week of 1974, inflation of nearly 25% in 1975 and the humiliating bail-out by the IMF in 1976. But they still earned 5.2%, after allowing for inflation, from equities over the next ten years, again in line with historic returns.

Of course, those examples are cherry-picked, in the knowledge that bear markets did come to an end. Still no one knows when the Japanese bear market will be over. In some markets (Russia in 1917, China in 1949) investors have been wiped out completely. However, if you look at the most extreme examples, you might as well give up; all private property rights were damaged by the Russian and Chinese revolutions.

The best way of thinking about market values is in terms of odds. Back in 1999-2000, they were against investors making money in equities over the long term, because of the likelihood that valuations would revert to the mean. Now the odds are more in investors' favour.

Goldman Sachs reckons the American equity market is around 32% below its "fair value" and 58% below its "equilibrium" level, which assumes a return to normal risk appetites. Today's prices might not be rock-bottom, but they do provide a margin of safety for investors who can afford to be patient.

Credit markets

Unsavoury spread

Mar 12th 2009
From The Economist print edition

The market for corporate bonds is struggling again

TEN years ago Warren Buffett and Jack Welch were among the most admired businessmen in the world. Emerging markets were seen as risky, to be avoided by the cautious. But now the credit-default swaps market indicates that Berkshire Hathaway, run by Mr Buffett, is more likely to default on its debt than Vietnam. GE Capital, the finance arm of the group formerly run by Mr Welch, is a worse credit risk than Russia and on March 12th Standard & Poor's downgraded its debt—the first time GE and its subsidiaries have lost their AAA rating in over five decades.

The contrast highlights the sorry state of the corporate-bond market. A turn-of-the-year rally was founded on hopes that spreads (the excess of corporate-bond yields over risk-free rates) more than compensated investors for the economic outlook. That has now petered out.

Reuters

Jack Welch in winning times

The weakness has been much greater in speculative, or high-yield, bonds than in the investment-grade part of the market. This is hardly surprising. First, economic prospects are so dire that companies already in trouble will have difficulty surviving. Banks are trying to preserve their own capital and do not need to own any more toxic debt. Even if refinancing were available for endangered firms, it would be prohibitively dear. It is only a matter of time before some go under.

Moody’s cites 283 companies at greatest risk of default, including well-known outfits like Blockbuster, a video-rental chain, and MGM Mirage, a casino group. A year ago just 157 companies made the list. Standard & Poor’s says 35 have defaulted this year, against 12 in the same period in 2008. That translates into a default rate over the past 12 months of just 3.8%.

The rate is likely to increase sharply. Charles Himmelberg, a credit strategist at Goldman Sachs, forecasts that 14% of high-yield bonds will default this year, with the same proportion going phut in 2010. Worse, creditors will get back only about 12.5 cents on the dollar. All told, Goldman thinks the combination of defaults and low recovery rates will cost bondholders 37 cents on the dollar in the next five years.

A second problem for the corporate-bond market is that optimism about the scope for an imminent end to the financial crisis has dissipated. “People have given up hope that the new [Obama] administration will be able to do anything to make things better quickly,” says Willem Sels, a credit strategist at Dresdner Kleinwort.

Banks are still the subject of heightened concern. Credit Derivatives Research has devised a counterparty-risk index, based on the cost of insuring against default of 15 large banks; the index is now higher than it was after the collapse of Lehman Brothers. Jeff Rosenberg, head of credit strategy at Bank of America Securities Merrill Lynch, says investors are uncertain about the impact of government intervention in banks. Each successive rescue, from Bear Stearns to Citigroup, has affected different parts of the capital structure in different ways.

A third problem for the high-yield market is that plans for quantitative easing (purchases by the central bank of government and private-sector debt) are focused on investment-grade bonds. As well as reviving the economy, governments are concerned about protecting taxpayers’ money, and so will not want to buy bonds at high risk of default. If the government is going to support the investment-grade market, investors have an incentive to steer their portfolios in that direction.

The relative strength of the investment-grade market even permitted the issuance of around $300 billion

of bonds in the first two months of the year, albeit largely for companies in safe industries such as pharmaceuticals. Circumstances suited all the market participants. “Spreads were wide, which attracted investors, but absolute levels of interest rates were low, which suited issuers,” says Mr Rosenberg.

Although the Dow Jones Industrial Average jumped by nearly 6% on March 10th, it is hard to see how the equity market can enjoy a sustained rebound while corporate-bond spreads are still widening. Bondholders have a prior claim on a company’s assets; if they are not going to be paid in full, then shareholders will not get a look-in. However, credit investors say their market often takes its lead from equities. If each is following the other, that hints at a worrying downward spiral.

Global insurance

The next domino?

Mar 12th 2009
From The Economist print edition

Insurance firms teeter on the brink

IF BANKS go bang, life insurance firms sputter. That was the theory going into the crisis. Both hold financial assets, like corporate debt, that have incurred losses, but the nature of insurers' liabilities should allow them to ride out short-term volatility. Banks depend on nervy depositors and wholesale lenders. Life insurers typically have low gearing, and the policyholders who fund the bulk of their assets are "sticky", with long-term contracts that incur penalty charges if they are cancelled. As a result regulators and credit-rating agencies promised to avoid knee-jerk reactions to mark-to-market losses. They were further reassured by the shift of insurers in the past decade from equities into supposedly safer credit investments, and their low exposure to the toxic structured-credit assets that blew up many banks.

Yet a year and a half into the financial crisis, this defence looks hollow. America's life insurers are now under siege, as fears mount about the losses on the non-government debt that forms about three-quarters of their assets. The symptoms are all too familiar: the firms' share prices have collapsed (see chart), their credit spreads have opened up and the credit-rating agencies have downgraded them. Twelve life firms have applied for emergency capital infusions from the Treasury and are expected to hear back within weeks. In Europe the market reaction has been almost as violent, with firms singled out if they are exposed to America, Britain or the Netherlands (annuity products backed by corporate bonds are common in all three). So far only Aegon, of the Netherlands, has been bailed out, but a number of rating downgrades are now expected, which could push more firms to the brink.

Throughout all this, solvency regulators on both sides of the Atlantic have maintained a monastic calm. But market confidence in their judgments has ebbed. In America, where insurers are supervised on a state-by-state basis, regulators' smoothed assessments of capital have been dwarfed by losses. Rob Haines, an analyst at CreditSights, a research firm, reckons that the big six life firms had regulatory capital of $43 billion at the end of 2008, but that this calculation excluded $80 billion of unrecognised mark-to-market losses, mainly on corporate bonds.

Likewise Europe's Insurance Group Directive, which governs capital levels, shows that almost every big firm enjoys a capital surplus. But in most continental countries this test excludes unrealised losses. British firms boast that their regulatory capital is marked to market, but in at least some cases they are engaging in the curious practise of tweaking their liabilities downward to compensate for losses on assets. Matthew Lilley, an analyst at Nomura, quips that at least with banks investors are prepared to trust one side of the balance-sheet.

Will insurers suffer banks' fate? A chunk of mark-to-market losses reflect illiquidity discounts on fairly high-quality bonds, which could unwind if markets normalise. But time is running out. Some American firms have reached a level of distress that will prompt customers to withdraw their business, whatever the penalties. And insurers do need to refinance some borrowings: $13 billion over the next four years for the big six American life firms, and $29 billion for the top 13 European insurers by assets. That will be difficult if solvency worries persist. The obvious solution is to raise more equity, but this is probably impossible given investors' mistrust of insurance firms' accounts, which can combine mind-numbing detail with mind-boggling sleights of hand.

All of which suggests that, faced with a gradual atrophying of their operations, many firms, particularly in America, are relying on a benevolent government to pump in cheap equity capital. Yet when it comes to bail-outs insurers differ from banks in another important respect: they are less important to the system.

Their very lack of short-term depositors and wholesale counterparties means it should be possible to restructure insurers' balance-sheets without causing a wider financial scare. That makes it more likely that the price of state support for zombie companies will be that bondholders take write-downs along with shareholders, in order to protect taxpayers and policy holders. Insurance firms may not go bang, but a few do look in real danger of going bust.

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Economics focus

A Plan B for global finance

Mar 12th 2009
From The Economist print edition

In a guest article, Dani Rodrik argues for stronger national regulation, not the global sort

THE clarion call for a global system of financial regulation can be heard everywhere. From Angela Merkel to Gordon Brown, from Jean-Claude Trichet to Ben Bernanke, from sober economists to countless newspaper editorials; everyone, it seems, is asking for it regardless of political complexion.

That is not surprising, perhaps, in light of the convulsions the world economy is going through. If we have learnt anything from the crisis it is that financial regulation and supervision need to be tightened and their scope broadened. It seems only a small step to the idea that we need much stronger global regulation as well: a global college of regulators, say; a binding code of international conduct; or even an international financial regulator.

Dani Rodrik

Dani Rodrik is a professor at Harvard University

Yet the logic of global financial regulation is flawed. The world economy will be far more stable and prosperous with a thin veneer of international co-operation superimposed on strong national regulations than with attempts to construct a bold global regulatory and supervisory framework. The risk we run is that pursuing an ambitious goal will detract us from something that is more desirable and more easily attained.

One problem with the global strategy is that it presumes we can get leading countries to surrender significant sovereignty to international agencies. It is hard to imagine that America's Congress would ever sign off on the kind of intrusive international oversight of domestic lending practices that might have prevented the subprime-mortgage meltdown, let alone avert future crises. Nor is it likely that the IMF will be allowed to turn itself into a true global lender of last resort. The far more likely outcome is that the mismatch between the reach of markets and the scope of governance will prevail, leaving global finance as unsafe as ever. That certainly was the outcome the last time we tried an international college of regulators, in the ill-fated case of the Bank of Credit and Commerce International.

A second problem is that even if the leading nations were to agree, they might end up converging on the wrong set of regulations. This is not just a hypothetical possibility. The Basel process, viewed until recently as the apogee of international financial co-operation, has been compromised by the inadequacies of the bank-capital agreements it has produced. Basel 1 ended up encouraging risky short-term borrowing, whereas Basel 2's reliance on credit ratings and banks' own models to generate risk weights for capital requirements is clearly inappropriate in light of recent experience. By neglecting the macro-prudential aspect of regulation—the possibility that individual banks may appear sound while the system as a whole is unsafe—these agreements have, if anything, magnified systemic risks. Given the risk of converging on the wrong solutions yet again, it would be better to let a variety of regulatory models flourish.

Who says one size fits all?

But the most fundamental objection to global regulation lies elsewhere. Desirable forms of financial regulation differ across countries depending on their preferences and levels of development. Financial regulation entails trade-offs along many dimensions. The more you value financial stability, the more you have to sacrifice financial innovation. The more fine-tuned and complex the regulation, the more you need skilled regulators to implement it. The more widespread the financial-market failures, the larger the potential role of directed credit and state banks.

Different nations will want to sit on different points along their "efficient frontiers". There is nothing wrong

with France, say, wanting to purchase more financial stability than America—and having tighter regulations—at the price of giving up some financial innovations. Nor with Brazil giving its state-owned development bank special regulatory treatment, if the country wishes, so that it can fill in for missing long-term credit markets.

In short, global financial regulation is neither feasible, nor prudent, nor desirable. What finance needs instead are some sensible traffic rules that will allow nations (and in some cases regions) to implement their own regulations while preventing adverse spillovers. If you want an analogy, think of a General Agreement on Tariffs and Trade for world finance rather than a World Trade Organisation. The genius of the GATT regime was that it left room for governments to craft their own social and economic policies as long as they did not follow blatantly protectionist policies and did not discriminate among their trade partners.

Fortify the home front first

Similarly, a new financial order can be constructed on the back of a minimal set of international guidelines. The new arrangements would certainly involve an improved IMF with better representation and increased resources. It might also require an international financial charter with limited aims, focused on financial transparency, consultation among national regulators, and limits on jurisdictions (such as offshore centres) that export financial instability. But the responsibility for regulating leverage, setting capital standards, and supervising financial markets would rest squarely at the national level. Domestic regulators and supervisors would no longer hide behind international codes. Just as an exporter of widgets has to abide by product-safety standards in all its markets, global financial firms would have to comply with regulatory requirements that may differ across host countries.

The main challenge facing such a regime would be the incentive for regulatory arbitrage. So the rules would recognise governments' right to intervene in cross-border financial transactions—but only in so far as the intent is to prevent competition from less-strict jurisdictions from undermining domestic regulations.

Of course, like-minded countries that want to go into deeper financial integration and harmonise their regulations would be free to do so, provided (as in the GATT) they do not use this as an excuse for financial protectionism. One can imagine the euro zone eventually taking this route and opting for a common regulator. The Chiang Mai initiative in Asia may ultimately also produce a regional zone of deep integration around an Asian monetary fund. But the rest of the world would have to live with a certain amount of financial segmentation—the necessary counterpart to regulatory fragmentation.

If this leaves you worried, turn again to the Bretton Woods experience. Despite limited liberalisation, that system produced huge increases in cross-border trade and investment. The reason is simple and remains relevant as ever: an architecture that respects national diversity does more to advance the cause of globalisation than ambitious plans that assume it away.

For a discussion of this article, see Economist.com/freeexchange

Electric vehicles

Batteries now included

Mar 12th 2009
From The Economist print edition

The missing piece of the electric-car jigsaw has just turned up

Corbis

IF YOU want to buy an electric car, you can. Tesla Motors, a firm based in San Carlos, California, will sell you a nifty open-top sports job for $109,000. Not cheap, admittedly, but cheap to run. Plugged in overnight, it can be refuelled for the equivalent of 25 cents a litre of petrol. The catch is, "plugged in overnight". Tesla's vehicles use standard lithium-ion battery cells. As any owner of a mobile phone or laptop computer knows, these take time to charge. If you use 6,831 of them, as a Tesla sports car does, that time does tend to drag on. Which is fine if you are not planning a long trip the following day, for a full charge will take you about 350km (220 miles). But it might cramp the style of anyone planning to bomb down from, say, Paris to Cannes, and who would therefore need to refuel on the way.

Gerbrand Ceder and Byoungwoo Kang of the Massachusetts Institute of Technology hope to change this, and thus help make the electric car a work-a-day consumer item, rather than a high-end boy's toy. In this week's *Nature* they have published the technical details of a new battery material that will, if all goes well, take the waiting out of wanting, at least when it comes to recharging.

Broadly speaking, there are two ways of storing electrical energy in a chemical system. One is a standard battery, in which the whole material of the electrodes acts as a storage medium. That allows lots of energy to be squirrelled away, but makes it relatively hard to get at—and so it can be released or put back in only slowly. The other way is called a supercapacitor. This stores energy only at the surface of the electrode. It is quick to charge and discharge, but cannot hold much energy. The great prize in the battery world has thus been a material that can both store a lot and discharge rapidly, and it is this that Dr Ceder and Mr Kang think they have come up with.

Nanogobstoppers

Lithium-ion batteries, as their name suggests, work by the movement of lithium ions (which carry a positive electric charge) along with electrons (which carry a negative charge). Electrons are small and mobile but lithium ions are much larger and slower. In a standard lithium-ion battery one electrode is made from a material such as lithium iron phosphate and the other from graphite. The ions pass from the graphite to the phosphate through an intervening electrolyte while the electrons make the journey via an external circuit that allows them to do useful work. When the battery is recharged, they go in the opposite

direction. (See videographic on how a lithium-ion battery works.)

It is the speed with which the ions can enter and leave the electrodes that governs how fast a battery can be charged and discharged. Graphite has an open structure and is easily penetrated. However, in the case of lithium iron phosphate and other, similar, materials, the crystal structure allows entrance and egress in only one direction. That creates a traffic jam that slows the movement of ions down.

What Dr Ceder and Mr Kang have done is create electrodes that are made of two different materials, one of which is good at storing ions while the other is good at conducting them. The two substances themselves are arranged in tiny spheres less than 50 billionths of a metre across. The core of each sphere is a crystal of lithium iron phosphate. This acts as a standard battery material. The surface, however, is made of a glassy (ie, non-crystalline) form of lithium phosphate. This lithium-phosphate glass is good at conducting lithium ions, though it cannot actually store many. It thus acts as a supercapacitor. The result is that any ion arriving at a sphere is quickly conducted around the surface by the supercapacitor phase until it finds its way to the right place to enter the battery phase in the core—or, if the battery in question is being charged, the other way round.

The really clever bit, though, is how the spheres are made. They crystallise from a melt that does not have enough iron in it to become pure lithium iron phosphate, so eventually no more of that material can form as the melt cools down. From then on the growing sphere is just lithium phosphate and, by manipulating the conditions, the researchers were able to make the coating glassy rather than crystalline.

The result is a material that, when tested in experimental batteries, was able to charge and discharge in a few seconds. In the future, therefore, that weekend in the south of France need not be interrupted by running out of juice.

Climatology

Historical determinism

Mar 12th 2009 | DALAT
From The Economist print edition

Tree rings are laying bare the climatic history of Asia

THE idea that climate change will lead to war is often raised by environmental pessimists, and a meeting on the climatic past of South-East Asia, held last month in Dalat, Vietnam, suggests it is not such an unlikely thought. The meeting was organised by the Lamont-Doherty Earth Observatory, part of Columbia University, some of whose researchers have been trying to reconstruct the pattern of South-East Asia's monsoons over the past few centuries. One matter they raised was the possibility that two periods of conflict in the area, in the 15th and 18th centuries, were provoked by droughts.

Historical records of the climate in Asia are lamentable outside India, where the weather-obsessed British collected good data during the 19th and 20th centuries. The observatory's researchers had therefore to rely on tree rings.

This is hard in South-East Asia. Many of the larger, and therefore older specimens in the area's forests have been logged. Even among those that remain, seasonal differences in the rings' growth rates are less noticeable than those that mark summer and winter in temperate climes. Ironically, the diversity of species in tropical forests also presents dendroclimatologists with problems. They would prefer just one or two types of tree, so that they could compare several samples of each more easily.

Nevertheless, Brendan Buckley, one of the observatory's researchers, found that a conifer called *Fokienia hodginsii*, which can live for more than 1,000 years, gave him the marker he needed. Using it, he has built up a series of tree-ring chronologies from Thailand and Vietnam that indicate a period of severe drought across mainland South-East Asia in the early 1400s.

This was the period when the city of Angkor in present-day Cambodia went into rapid decline, a fact that some historians have blamed on invasions by the rival Siamese and Champa kingdoms. Dr Buckley's data, however, suggest another possibility—that Angkor's canals and reservoirs ran dry and that the invasions were therefore a consequence of decline, rather than its cause. Similarly, another prolonged drought in the 18th century, which was noted by foreign visitors to Siam (modern-day Thailand), coincided with a series of political upheavals that included the sacking of the Siamese capital by Burmese invaders.

The question is what causes such droughts in South-East Asia? El Niño, a periodic warming of the eastern Pacific Ocean, is part of the answer. It corresponds with a weaker south-west monsoon and a longer dry season. It cannot, however, be the whole explanation. Dr Buckley's tree cores show that the 18th-century drought in Siam lasted 30 years or more. That should have corresponded with a warmer Pacific but according to Kevin Anchukaitis, another of the observatory's researchers, data from coral suggest it did not.

The answer may lie in the Indian Ocean, which also influences monsoon patterns, rather than in the Pacific, and there is some evidence that the Indian Ocean was indeed cooler during the 18th-century drought. The details, though, remain obscure—which serves as a reminder of just how much remains to be found out before even the local climate truly becomes explicable.

Climate change

A sinking feeling

Mar 12th 2009
From The Economist print edition

Sea levels are rising twice as fast as had been thought

SCIENCE and politics are inextricably linked. At a scientific conference on climate change held this week in Copenhagen, four environmental experts announced that sea levels appear to be rising almost twice as rapidly as had been forecast by the United Nations just two years ago. The warning is aimed at politicians who will meet in the same city in December to discuss the same subject and, perhaps, to thrash out an international agreement to counter it.

The reason for the rapid change in the predicted rise in sea levels is a rapid increase in the information available. In 2007, when the Intergovernmental Panel on Climate Change convened by the UN made its prediction that sea levels would rise by between 18cm and 59cm by 2100, a lack of knowledge about how the polar ice caps were behaving was behind much of the uncertainty. Since then they have been closely monitored, and the results are disturbing. Both the Greenland and the Antarctic caps have been melting at an accelerating rate. It is this melting ice that is raising sea levels much faster than had been expected. Indeed, scientists now reckon that sea levels will rise by between 50cm and 100cm by 2100, unless action is taken to curb climate change.

Konrad Steffen of the University of Colorado, Boulder, leads one study of the Greenland ice sheet. He told the conference that this sheet is melting not only because it is warmer but also because water seeping through its crevices is breaking it up. This effect had been neglected in the earlier report.

The impact of the melting ice has been measured by John Church of the Centre for Australian Weather and Climate Research. He told the conference that satellite and ground-based systems showed that sea levels have been rising more rapidly since 1993 than they were earlier in the 20th century. He is concerned that more climate change could cause a further acceleration in this rate.

Stefan Rahmstorf of the Potsdam Institute for Climate Impact Research has examined data stretching over 125 years that link increases in sea temperatures to rises in sea levels. He told the conference that, based on past experience, "I expect that sea-level rise will accelerate as the planet gets hotter." He was supported in this view by the fourth expert, Eric Rignot of the University of California, Irvine, who called for the world's leaders to slash the emission of carbon dioxide and other greenhouse gases.

Advance negotiations on the UN Climate Change Conference are due to begin in Bonn in just over a fortnight's time. The scientists hope that their startling warnings will change the outcome of that pre-meeting meeting. With much still to argue over, they hope that a clear scientific lead will both help to narrow the room for disagreement and galvanise the desire to get a treaty agreed.

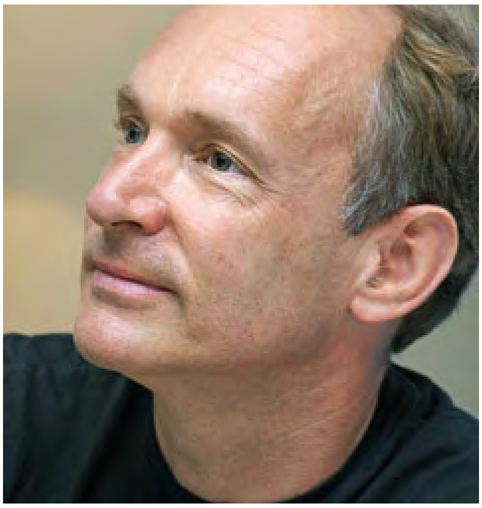
Twenty years of the world wide web

What's the score?

Mar 12th 2009
From The Economist print edition

Science inspired the world wide web. Two decades on, the web has repaid the compliment by changing science

Rex Features



A proud father

"INFORMATION Management: A Proposal". That was the bland title of a document written in March 1989 by a then little-known computer scientist called Tim Berners-Lee who was working at CERN, Europe's particle physics laboratory, near Geneva. Mr Berners-Lee (pictured) is now, of course, Sir Timothy, and his proposal, modestly dubbed the world wide web, has fulfilled the implications of its name beyond the wildest dreams of anyone involved at the time.

In fact, the web was invented to deal with a specific problem. In the late 1980s, CERN was planning one of the most ambitious scientific projects ever, the Large Hadron Collider, or LHC. (This opened, and then shut down again because of a leak in its cooling system, in September last year.) As the first few lines of the original proposal put it, "Many of the discussions of the future at CERN and the LHC era end with the question—'Yes, but how will we ever keep track of such a large project?' This proposal provides an answer to such questions."

Sir Timothy is now based at the Massachusetts Institute of Technology, where he runs the World Wide Web Consortium, which sets standards for web technology. But on March 13th, he will, if all has gone well, have joined his old colleagues at CERN to celebrate the web's 20th birthday.

The web of life

The web, as everyone now knows, has found uses far beyond the original one of linking electronic documents about particle physics in laboratories around the world. But amid all the transformations it has wrought, from personal social networks to political campaigning to pornography, it has also transformed, as its inventor hoped it would, the business of doing science itself.

As well as bringing the predictable benefits of allowing journals to be published online and links to be made from one paper to another, it has also, for example, permitted professional scientists to recruit thousands of amateurs to give them a hand. One such project, called GalaxyZoo, used this unpaid labour to classify 1m images of galaxies into various types (spiral, elliptical and irregular). This enterprise, intended to help astronomers understand how galaxies evolve, was so successful that a successor has now been launched, to classify the brightest quarter of a million of them in finer detail. More modestly, those involved in Herbaria@home scrutinise and decipher scanned images of handwritten notes about old plant cuttings stored in British museums. This will allow the tracking of changes in the distribution of species in response to, for instance, climate change.

Another novel scientific application of the web is as an experimental laboratory in its own right. It is allowing social scientists, in particular, to do things that would previously have been impossible.

We recently reported two such projects. One used a peer-to-peer moneylending site to show that a person's physiognomy is a reliable predictor of his creditworthiness (see article). The other, carried out at the behest of *The Economist*, confirmed anthropologists' observations about the sizes of human social networks using data from Facebook (see article). A second investigation of the nature of such networks, which came to similar conclusions, has been produced by Bernardo Huberman of HP Labs, Hewlett-Packard's research arm in Palo Alto, California. He and his colleagues looked at Twitter, a social networking website that allows people to post short messages to long lists of friends.

At first glance, the networks seemed enormous—the 300,000 Twitterers sampled had 80 friends each, on average (those on Facebook had 120), but some listed up to 1,000. Closer statistical inspection, however, revealed that many of the messages were directed at a few specific friends, revealing—as with Facebook—that an individual's active social network is far smaller than his "clan".

Dr Huberman has also helped uncover several laws of web surfing, including the number of times an average person will go from web page to web page on a given site before giving up, and the details of the "winner-takes-all" phenomenon whereby a few sites on a given subject grab most of the attention, and the rest get hardly any.

Scientists have therefore proved resourceful in using the web to further their research. They have, however, tended to lag when it comes to employing the latest web-based social-networking tools to open up scientific discourse and encourage more effective collaboration.

Journalists are now used to having their every article commented on by dozens of readers. Indeed, many bloggers develop and refine their essays on the basis of such input. Yet despite several attempts to encourage a similarly open system of peer review of scientific research published on the web, most researchers still limit such reviews to a few anonymous experts. When *Nature*, one of the world's most respected scientific journals, experimented with open peer review in 2006, the results were disappointing. Only 5% of the authors it spoke to agreed to have their article posted for review on the web—and their instinct turned out to be right, as almost half of the papers that were then posted attracted no comments.

Michael Nielsen, an expert on quantum computers who belongs to a new wave of scientist bloggers who want to change this, thinks the reason for this reticence is neither shyness or fear of reprisal, but rather a fundamental lack of incentive.

The unsocial scientist

Scientists publish, in part, because their careers depend on it. They keenly keep track of how many papers they have had accepted, the reputations of the journals they appear in and how many times each article is cited by their peers, as measures of the impact of their research. These numbers can readily be put in a *curriculum vitae* to impress others.

By contrast, no one yet knows how to measure the impact of a blog post or the sharing of a good idea with another researcher in some collaborative web-based workspace. Dr Nielsen reckons that if similar measurements could be established for the impact of open commentary and open collaboration on the web, such commentary and collaboration would flourish, and science as a whole would benefit. Essentially, this would involve establishing a market for great ideas, just as a site such as eBay does for coveted objects.

How to do that is, at the moment, mysterious. Intellectual credit obeys different rules from the financial sort. But if some keen researcher out there has an idea about how to do it, "Information Management: A Proposal" might be an equally apposite title for his first draft. Who knows, there may even be a knighthood in it.

Economist.com BOOKS & ARTS

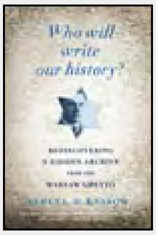
The Warsaw ghetto

From beyond the grave

Mar 12th 2009
From The Economist print edition

A remarkable secret archive tells the story of life in the Warsaw ghetto

Who Will Write our History? Rediscovering a Hidden Archive from the Warsaw Ghetto
By Samuel D. Kassow



Vintage; 522 pages; $16.95. Allen Lane; £10.99

Corbis

THE Nazis succeeded in exterminating millions of Jews. But they did not succeed in extinguishing their history. That is the story told by Samuel Kassow, an American historian, in a poignant and detailed account of the secret archive of the Warsaw ghetto.

In the autumn of 1940, Warsaw’s Jewish population, swollen by forced immigration, amounted to nearly 450,000 people, all of them walled into an area covering less than four square kilometres. By early 1942 about 83,000 had died from hunger. That summer 300,000 were sent away to death camps, mostly to Treblinka. In April and May 1943 the remaining 60,000 were killed, or captured and deported, in the Warsaw ghetto uprising, during which the Germans levelled that part of the city.

Mr Kassow starts his story amid the passionate arguments among Jews in the declining days of the three great empires: the German, the Austro-Hungarian and the Russian. Was the great dream to be integration? Was it in identification with the surging national consciousness of countries such as Poland, at that stage still partitioned? Was it emigration to a Jewish state in Palestine? Or in the hope of a socialist paradise based on a brotherhood of man rather than ethnic, religious or national affiliation? Or some mixture of the above? Was Hebrew the real language of Jews, or a snooty, artificial distraction? Was Yiddish a degenerate linguistic compromise, or the essential literary and political medium?

After the first world war, those arguments became more pressing. A Jewish state was taking embryonic form in Palestine. The Soviet authorities launched a rival Yiddish-speaking Jewish homeland, Birobidzhan, in a desolate corner of the Russian far east. The newly reborn Polish republic offered the chance of partnership with gentile Poles in a common homeland, albeit one marred by prejudice and discrimination.

The task for Jewish historians in those years was finding an account of their past that would help make sense of the arguments about the present. What role, for example, had Jews played in the Polish monarchy before its dismemberment in 1795? Was the Polish-Lithuanian Commonwealth really a paradise of tolerance, or was that just another myth among so many others? Gentile historians' accounts were inevitably partial. The Jewish collective memory, with its colourful, folkloristic stereotypes of poor beggars, rich merchants and pious rabbis, was a help, but not an answer. Documents were scanty or missing altogether.

That effort gathered pace after Poland regained its independence in 1918. A pioneer was the young Emanuel Ringelblum, a passionate activist in the left-wing Poale Zion movement. Starting as a student in 1920, he was to become one of his country's best historians, up to his death in the ruins of the Warsaw ghetto in 1944. Ringelblum is the central character in this book; although it is not a formal biography, the author does an excellent job of accumulating the scraps of information and recollection that have survived the human and archival destruction of the war.

With fine Yiddishist instinct, Mr Kassow does an excellent job too of evoking the atmosphere of those years, particularly the YIVO institute in Wilno (now Vilnius), which was founded in 1925 to give class and clout to Jewish scholarly efforts. The early chapters of the book, full of hope and productive energy, make the final ones all the more effective. The hugely subtle, interesting and complicated world of Jewish thought and culture boiled down to a bitter fight over bread or over scrappy permits; either might hold off death for another few days.

The Jews of the Warsaw ghetto could not prevent their own murder. But thanks to the Oyneg Shabes, the secret archive organised by Ringelblum and other historians, at colossal personal risk, they were at least able to record what they thought, felt and saw. The archive ranged from raw eyewitness accounts to scholarly histories, such as Ringelblum's own lengthy analysis of Polish-Jewish relations. About 35,000 pages (only a fraction of the whole) survived the war, buried in milk churns and tin boxes. Some were carefully soldered shut; others had leaked, leaving an illegible soggy lump requiring painstaking conservation work. That the documents came to light at all is thanks to the persistence of Rachel Auerbach, one of only three survivors of hundreds of people involved in the project. It was she who went to Warsaw in 1946 and demanded that the cold and hungry survivors of the city's destruction make the effort to dig out the caches from the ruins.

Locked up for years in the Jewish Historical Institute in Warsaw, the documents have only recently been substantially restored. A full catalogue has yet to be made, but the papers about Ringelblum that Mr Kassow has studied give a vivid, sometimes unbearable, picture of the ghetto's destruction at the hands of the Nazis, and of the efforts made to preserve a semblance of civilised life that had succumbed to the elemental desire for survival.

The archive also illustrates the tension that exists between the Jewish and gentile experience of the war in Poland. The summer of 1939 had aroused a remarkable sense of solidarity between both peoples; that soon gave way to harsher feelings. Some Polish gentiles outside the ghetto taunted its inmates for their passivity (while at the same time grudging them supplies of arms and ammunition). Nazi anti-semitic propaganda about "Judeo-Communism" had some effect. So did self-interest; dead Jews were unlikely to want their pre-war property back. A poignant short piece by a Jewish poet, Wladyslaw Szlengel, an ardent Polish patriot, sums it up. With no gentile Polish friends left to talk to, he takes comfort in telephoning the speaking clock.

> How great it is to talk to you
> No quarrels, no words

You are nicer, my little time clock
Than all my former friends.

It is a pity that the author does not give a little space to the view of the ghetto from the outside. And the use of “Pole” as the antonym for “Jew” may jar with some. Many of the people he writes about would have said they were both. But the book remains an informative and moving reminder of what was lost in the Holocaust and the ingenuity and heroism of those who tried to frustrate its perpetrators.

Who Will Write our History? Rediscovering a Hidden Archive from the Warsaw Ghetto.
By Samuel D. Kassow.
Vintage; 522 pages; $16.95. Allen Lane; £10.99

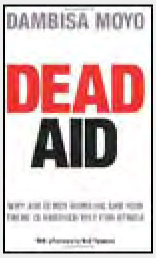
Foreign aid

Voice of disenchantment

Mar 12th 2009
From The Economist print edition

TEN years ago, it would have been hard to find anyone to question the wisdom and morality of the rich world giving billions of dollars in help to the poor world. A generation reared on Live Aid held these truths to be self-evident. Now, the intellectual trend is all the other way. A stream of economists, politicians and even disillusioned do-gooders have penned powerful critiques of every aspect of aid and the aid industry; men like Paul Collier, William Easterly and Robert Calderisi. Even the high priests of aid, pop stars such as Bono and Bob Geldolf, now preach a much more nuanced and complex gospel than they did in the 1980s.

Dead Aid: Why Aid is Not Working and How There is Another Way for Africa
By Dambisa Moyo



Farrar, Straus and Giroux; 208 pages; $24. Allen Lane; £14.99

Yet the intellectual arguments about aid are still conducted largely within a small circle of Western white men. So it is good to welcome a new voice to the debate, and a black African woman too, Dambisa Moyo, a Zambian economist at Goldman Sachs. It is remarkable that so few voices have been raised in Africa, supposedly the main beneficiary of the world's largesse, about how the aid money should be spent, or even whether it should be received at all.

Unfortunately, Ms Moyo's contribution ends there, for "Dead Aid" does not move the debate along much. Yes, she has joined the chorus of disapproval—and that in itself might surprise a few diehards who think that Africans should just be grateful for the aid and shut up. But her arguments are scarcely original and her plodding prose makes her the least stylish of the critics.

Moreover, she overstates her case, almost to the point of caricature. There is almost nobody left, even in the aid lobby, who seriously thinks that bilateral (government-to-government) aid is the sole answer to world poverty, as she suggests. "Trade not aid" is only one of several newish mantras among aidniks that seem to have passed her by.

Nonetheless, Ms Moyo is right to argue that the rich world—and Africa—should now focus on other ways of helping poor countries. Ms Moyo shows how some countries, such as Ghana, have successfully tapped the bond markets for funds. She also has good discussions on the virtues of microfinance, venture capital and liberalising trade. By concentrating on these three, African governments might well raise more money on their own; some might even lessen their dependency on aid.

Private investors will always require good governance to ensure that their dollars are not misused. This "trumps all", argues Ms Moyo. She won't find many Africans who disagree with that. But getting governments like Nigeria's or Kenya's actually to walk the talk has proved a much tougher proposition.

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Farrar, Straus and Giroux; 208 pages; $24. Allen Lane; £14.99

Fighting insurgencies

Reluctant warriors

Mar 12th 2009
From The Economist print edition

AMERICA'S disastrous war in Iraq was salvaged by an unlikely collection of dissident generals, think-tank scholars and foreign experts. The "surge" of troops launched in 2007, along with the adoption of new counter-insurgency tactics and a favourable realignment of political forces, all combined to pull Iraq back from a full-blown civil war—and made a celebrity of General David Petraeus.

Thomas Ricks, a military correspondent for the *Washington Post*, and David Kilcullen, a former Australian army officer who served as an adviser to the general, further burnish his reputation with two new accounts of the surge. Mr Ricks's acclaimed previous book, "Fiasco", chronicled America's march towards perdition in Iraq. "The Gamble" tells the story of its (partial) redemption, led by General Petraeus and the other prophets of counter-insurgency such as Mr Kilcullen.

The book recounts the manoeuvres that led to the 11th-hour change of course in January 2007 to try to avoid a humiliating defeat. General Ray Odierno, then the second-most-senior commander in Iraq, went behind the backs of his superiors to seek extra troops at a time when the top brass was set on reducing forces. He was greatly helped in Washington by a retired general, Jack Keane, whose advocacy was so successful that there were some who regarded him as the real chairman of the joint chiefs of staff, America's overall military commander.

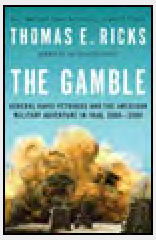
General Petraeus, who had just written a mould-breaking new manual on counter-insurgency, was put in charge. Instead of trying to capture and kill insurgents—standard procedures required soldiers to kick down doors and fire two bullets into the chest of any suspected insurgent—the general told his soldiers their main task was henceforth to "protect the population". In a further move, he had soldiers set up small outposts to live among the people and reclaim areas lost to insurgents instead of commuting from their bases along predictable routes to different hotspots.

Until then American commanders had been operating under the assumption that their presence among Iraqis was feeding resentment. Yet the more they withdrew from towns, the more the insurgency intensified. Mr Ricks quotes one key commander as recounting how American forces would tell Iraqis: "Don't worry, we're leaving." With the new tactics, they would tell them: "We're staying until we win this fight."

General Petraeus benefited from some good luck too. Sunni tribes were already rising up against al-Qaeda's murderous followers before the surge, and the Shia militia led by the hardline cleric, Muqtada al-Sadr, declared a ceasefire. But fortune smiles on a military commander who knows how to exploit a good opportunity. Perhaps the best assessment of General Petraeus (intelligent, fiercely competitive, fanatical about fitness and, probably inevitably, also arrogant) comes from an unnamed American officer who says: "David Petraeus is the best general in the US Army, bar none. He also isn't half as good as he thinks he is."

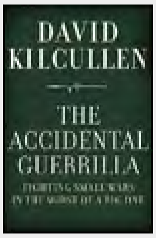
However, despite material that is rich in both vignettes and interviews, Mr Ricks's book comes as something of a disappointment. It has the feel of a manuscript written in a hurry. The structure is messy and the author makes use of too many long quotes, tediously parsing speeches at the expense of providing rigorous analysis. He treats counter-insurgency doctrine as a fixed revelation, divorced from history or culture, without much discussion of its limits or contradictions.

The Gamble: General David Petraeus and the American Military Adventure in Iraq, 2006-2008
By Thomas E. Ricks



Penguin; 400 pages; $27.95. Allen Lane; £25

The Accidental Guerrilla: Fighting Small Wars in the Midst of a Big One
By David Kilcullen



Oxford University Press; 384 pages; $27.95. To be published in Britain by Hurst in April

For a wider perspective on the lessons drawn over the past seven years of the “war on terror”, the reader can do no better than turn to Mr Kilcullen’s excellent book. “The Accidental Guerrilla” has an anthropologist’s sense of social dynamics and a reporter’s eye for telling detail. If T.E. Lawrence evoked the means of waging irregular warfare in his 1926 classic, “Seven Pillars of Wisdom”, Mr Kilcullen describes the practitioner’s art of combating insurgents. For instance, his account of how the Americans use soft and hard power to pacify parts of eastern Afghanistan—combining road-building with focused operations—should be compulsory reading in military academies on both sides of the Atlantic.

Mr Kilcullen draws on experiences from many places—not just Iraq, but also Afghanistan, Pakistan, Indonesia and even Europe—to try to understand the nature of global jihadist militancy. He offers four overlapping, if imperfect, ways of analysing the phenomenon: as part of a reaction against globalisation; part of a global Muslim insurgency; the result of a civil war within Islam itself; and a rebellion of the weak against America’s might.

All this makes the Iraq war fiendishly complex; it is “an insurgency plus a terrorist campaign plus a sectarian civil war, sitting on top of a fragile state within a divided, unstable region,” says Mr Kilcullen. Classical notions of counter-insurgency, which emphasise building up indigenous forces, may be counter-productive if that ends up strengthening one side of a sectarian war. Conversely, creating Sunni tribal militias, successful against al-Qaeda in the short term, may ultimately weaken the central government. Mr Kilcullen quotes one Iraqi officer as warning him: “You have taken a crocodile as a pet.”

Mr Kilcullen is a reluctant warrior. Many of those fighting the West, he argues, are “accidental guerrillas”, driven to making common cause with violent extremists by the perceived need to defend themselves against American intervention. The invasion of Iraq, he says, was a grievous self-inflicted wound. Having learnt, impressively but painfully, how to do a better job of fighting insurgencies, America should not rush into more such wars. The watchword, he says, should be “never again”. But nor should it give up its hard-won expertise. It may need it in future.

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John Cheever

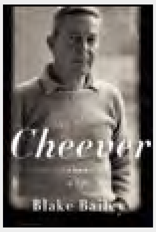
Buttoned up

Mar 12th 2009
From The Economist print edition

THE big names of 20th-century American literature are recognisable for their robust alter egos: Nathan Zuckerman, Moses Herzog, Harry "Rabbit" Angstrom, Holden Caulfield. Sweaty, anxious and empathetic, these characters push up through their novels with an energy that still draws and captivates readers.

But what about John Cheever? Before he died in 1982, Cheever was ranked third, behind Saul Bellow and John Updike, in a survey of living American writers whose work would live on for generations. "The Stories of John Cheever", his acclaimed collection of short fiction, won the Pulitzer prize among other awards and went on to sell 125,000 copies in hardback. Yet, today, Cheever has largely been forgotten, left off academic reading lists and overlooked as an influence on subsequent writers.

Cheever: A Life
By Blake Bailey



Knopf; 784 pages; $35

The time may have come, however, for a Cheever revival. Blake Bailey, an American literary biographer, has written an insightful, clear-eyed life of the man, just as the venerated Library of America is reissuing a two-volume collection of Cheever's stories and novels, also edited by Mr Bailey. Measured together these books make quite a pile, but Mr Bailey presents an elegant case for their heft.

Cheever's books have slipped from public notice in part because his oeuvre lacks a charismatic torchbearer like Holden Caulfield. His calling was the short story—a form with "the life expectancy of a mayfly", he conceded. Cheever knew he needed to write a novel to be taken seriously (he ultimately eked out five), yet financial necessity and his gift for the medium led him to write more than 150 short stories, most of them published in the *New Yorker*.

Subtle and well observed, they followed ordinary members of the suburban middle-class. They all drank too much, the Cabots and the Westerhazys, the Grahams and the Howlands. They were unnerved by how old they were, how boring things could be, how tired they were of their marriages. They were conscious of social codes and proper attire, and rarely said anything profound.

Cheever's stories seemed pessimistic, like "a sort of apocalyptic poetry", observed Malcolm Cowley at the *New Republic*, who published Cheever's first one, "Expelled", when he was just 18. But they were filled with longing and desire, a yearning for something just out of reach. He understood these characters. He pitied the bickering young couples and ageing alcoholics without sentimentalising them. He valued their grasps at youth, companionship and memory. Asked why he bothered to write at all if he thought everything was so terrible, he replied, "I write to make sense of my life."

Cheever: A Life.
By Blake Bailey.
Knopf; 784 pages; $35

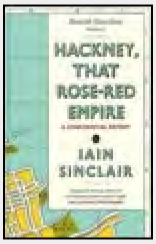
Iain Sinclair

The psychogeography of Hackney

Mar 12th 2009
From The Economist print edition

IN 1959 a busty Hollywood actress, Jayne Mansfield, came to Hackney to present prizes at the East London Budgerigar and Foreign Birds Society show. On her way in she handed her coat to an onlooker, assuming, mistakenly, that he was there for the purpose. This was Tony Lambrianou, a 17-year-old budding criminal and future associate of the criminal Kray twins, who then attempted to offload the coat at local pubs. Unsuccessful, even for the price of a drink, he ended up selling it to the owner of a market stall who tucked it away with other second-hand items where it faded, slowly, into obscurity.

Hackney, That Rose-Red Empire: A Confidential Report
By Iain Sinclair



Hamish Hamilton; 581 pages; £20

Buy it at
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This story may or may not be true. It is also a perfect snapshot of Hackney: social history, local culture, transient celebrity—all tarnished by crime. Over the past seven years, since writing a book about London's orbital motorway, the M25, Iain Sinclair, a former poet, has gained a reputation as the country's leading proponent of "psychogeography"—the study of the effects of the geographical environment on people's emotions and behaviour.

Hackney is a mishmash, where newly built luxury flats housing the City's more adventurous bankers and lawyers compete with ill-conceived concrete estates that make even the police hesitate. Some of the houses, shops and municipal buildings that have played a part in the author's own history remain; others have been sold or abandoned, their residents relocating to more salubrious locations, taking pieces of Hackney's history with them.

Much of that history has been preserved by the author in photographs, home movies and interviews, some transcribed here. The reader is introduced to a mixed bag of Hackney's residents, past and present, not only the obvious writers, artists and film-makers, but a huge cast of less likely collaborators: an academic who doubles as a bus-driver; a dowser in search of ley lines; a former German terrorist; William Lyttle, the infamous Mole Man of Mortimer Road who spent 40 years digging a labyrinth of tunnels under his dilapidated Victorian house. Mr Sinclair gives them all a platform from which to tell their stories (although slyly undermining his own technique by quoting one of them as saying that only a fool would "think cobbled-together interview transcripts make a proper book"). This is not a work designed to encourage tourism. But it does make you think—about city living and memories.

Hackney, That Rose-Red Empire: A Confidential Report.
By Iain Sinclair.
Hamish Hamilton; 581 pages; £20

The influence of Cézanne

Apples and oranges

Mar 12th 2009 | PHILADELPHIA
From The Economist print edition

A new exhibition shows the master's long reach

Ellsworth Kelly

Fruitful work

PAUL CEZANNE, who died in 1906, cast a long shadow across 20th-century art. Pablo Picasso, who, with Georges Braque, invented cubism, called him "my one and only master". Henri Matisse, Picasso's rival for supreme artist of the modern period, described him as "a sort of god of painting".

Critics and scholars may disagree about pinpointing the first stirrings of modern art, but few deny Cézanne's pivotal role as midwife. His fracturing of form and flattening of space, especially evident in his landscapes and still lifes, laid the foundation for cubism, the revolutionary movement that planted radical ideas firmly in the minds of young painters in Europe and America.

Cézanne's influence was strongest during the generation after he died, but it has proved remarkably persistent. Only now, a century later, when electronic media such as photography and video have wrested control of the vanguard from painting, is Cézanne's shadow beginning to fade.

However, until mid-May he continues to display his authority at the Philadelphia Museum of Art, which has mounted an enchanting exhibition designed to validate the claims of Picasso, Matisse and 14 other legatees whose art has been shaped by Cézanne's example.

"Cézanne and Beyond" juxtaposes about 60 paintings and watercolours by the French master with roughly twice that many by the others: Europeans such as Piet Mondrian, Fernand Léger, Max Beckmann and Alberto Giacometti, and Americans—Marsden Hartley, Charles Demuth, Jasper Johns and Ellsworth Kelly whose "Apples" is shown above.

The aim is to illuminate stylistic similarities and show how Cézanne expanded the way artists think. Confronted by such iconic subjects as Mont St Victoire near Cézanne's home in Aix-en-Provence and his magisterial still lifes of apples, they could no longer simply reproduce nature, they had to deconstruct it. The cubists provide the most vivid examples of this transformation but the most contemporary of the 16, especially Mr Kelly, Brice Marden and Canadian photographer Jeff Wall, have devised more subtle ways of incorporating Cézanne's principles into their work.

"Cézanne and Beyond" is a beautiful and powerful collection of modern and post-modern art by some of the most talented painters of the past 100 years. It is also the most impressive survey of Cézanne's painting in America since a 1996 retrospective, also in Philadelphia (as well as London and Paris). This time it is three exhibitions in one, courtesy of the last Old Master.

Correction: Yves Saint Laurent

Mar 12th 2009
From The Economist print edition

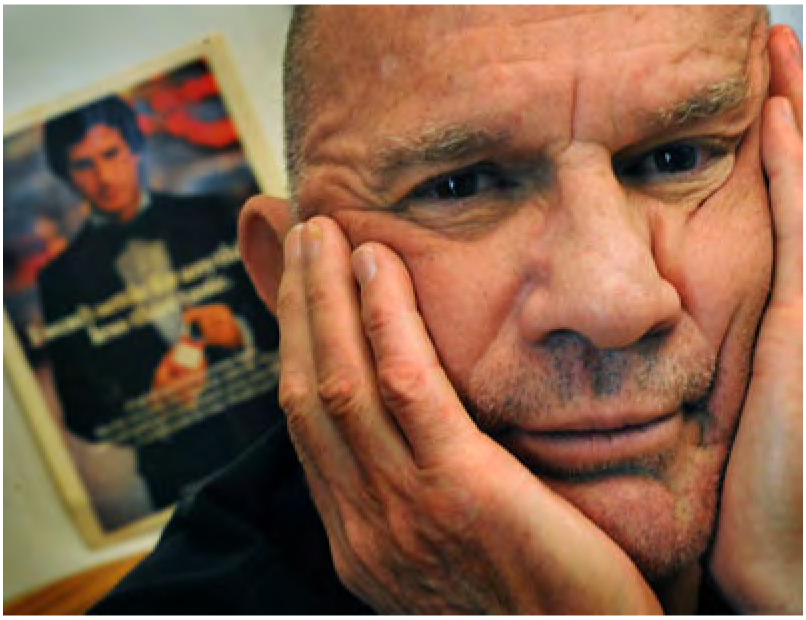
Our report on the Yves Saint Laurent sale, "Caveat venditor" (March 7th), suggested that Henry and Marie-Josée Kravis may have been the purchasers of an early 20th-century chair designed by Eileen Gray. Mr Kravis assures us that neither he nor anyone in his family bought the chair in question. Our apologies to all concerned.

Alan Landers

Mar 12th 2009
From The Economist print edition

Alan Landers, ex-smoker, died on February 27th, aged 68

Robert Duyos, Sun Sentinel



BY THE time he posted his last blog, on February 16th, life was getting rough for Alan Landers. Radiation treatment every day for tonsillar cancer was filling his throat and mouth with sores. This made it hard to swallow and harder to speak, though his voice had long ago sunk to a growl since a botched operation on his voice box in 1993. He was totally bald, although he had buzzed his hair off himself, since he was going to go bald anyway.

The worst part wasn't the hospital sessions. It wasn't even the cancer diagnoses, the first in 1987 and the second in 1992 when the doctor had beeped him while he was driving, and he'd pulled off and gone into a 7-Eleven to be told that he had a tumour on his left lung the size of a golf ball. Some nights he was in blank terror of death, but in the morning he could deal with it. The worst part was arguing with the insurance company because he wanted to go to the hospital in Miami and not Fort Lauderdale, and worrying that he couldn't make the co-payments on his treatment. Every procedure cost him $25, and there were many of them. Living as he did in a one-bed flat, with a few sticks of furniture and no wife to look after him, unable to give acting lessons any more, all he could do was beg on the internet for a little of the $25,000 he reckoned he needed. He was feisty in the video, though his voice gave out when he tried to say "incurable".

Mr Landers never had any doubt about who was to blame for his condition. The big tobacco companies had intentionally hooked their customers on nicotine; they had conspired to conceal the fact that cigarettes were deadly; and he had been lured into "the biggest con of the 20th century". To help shatter the illusion that cigarettes were cool he visited schools, testified to Congress and gave public lectures, pulling off his shirt to show the operation scars that wrapped halfway round his back. He was not involved in the $145 billion class-action suit brought by 700,000 Floridians against Big Tobacco in 1994, the one that was eventually thrown out in 2006 after generating enough paper to make a stack five feet high in the Palm Beach County courthouse. But he was one of the 9,000 victims of tobacco who had been given leave to bring his own case, and in April he was scheduled to. He had no doubt the cigarette companies would be only too glad to see him die first, but he was damned if he was going to give them that satisfaction.

His case was all the more powerful because, for a spell in the 1960s and 1970s, he had been the face of Winston cigarettes. Dark and brooding, in a tux and with vaguely Hollywood lights blurring behind him, he was photographed sliding a Winston seductively from its packet. "I won't settle for anything less than

taste," ran the blurb. Cigarette reliably in hand, he poured champagne, hugged beautiful women, brought home the Christmas tree. "Winston tastes good like a cigarette should." Where the Marlboro Man juggled cigarettes with a coiled lasso or a horse, Mr Landers tended to kick about in New England snow. But on the back of his smooth smoking, which paid $3,000 a day, he appeared in *Cosmopolitan*, *GQ* and Vogue and was the centrefold in *Playgirl* magazine. He got bit-parts in "Annie Hall" and "America's Most Wanted", lived in Los Angeles, and was treated like a star by his family whenever he came back to Lakeland.

A perfect plume

This was exactly what he had hoped for when, well before his bar mitzvah—probably at nine or ten—he had first lit up the little white tube and sucked in the taste of tar. At the cinema on Saturdays, sneaked in free by his usher-brothers, he would watch sad-eyed Bogart in his raincoat, wreathed in smoke; John Wayne squinting into the sun from under the brim of his stetson, lighting up; Montgomery Clift getting the girl while the plume of his cigarette described a perfect treble clef. Smoking was cool: "You weren't considered a man unless you were smoking."

That he was an innocent victim was harder to say. Mr Landers claimed that as a model he was made to smoke as many as four packets at a session, trying for that perfect quarter-inch of ash and delicate swirl of smoke. But R.J. Reynolds never made him finish those cigarettes, or smoke his two-and-a-half packets a day off the set, or light up (as he did) the moment he woke. No one forced him to indulge the false glamour of the weed. Besides, from 1966 every packet of Winstons had carried the warning that "smoking may be hazardous to your health". And if he doubted that, he had only to note that in his own hard-smoking family a grandfather, an uncle and an aunt had all died of lung cancer.

Mr Landers argued back that he was too far gone by then, and that the government warnings had never been forceful enough. In an up-and-down life, including a brush with cocaine in the 1980s that wiped out his finances and got him convicted for armed robbery, it was hard to quit. He tried the patches and the gum with no success, and stopped smoking at last only when his medical prognosis got too grim to ignore.

He was desperately ashamed that he had ever promoted tobacco. To the end, in a rough and ever-fainter whisper, he condemned it. Whether he could out-argue those clean-cut fireside frolics, with "real pleasure" dangling from his lower lip, he never knew. He hoped so.

Overview

Mar 12th 2009
From The Economist print edition

America 's unemployment rate rose to 8.1% in February from 7.6% in January. The jobless rate for Hispanics and blacks rose more quickly than the average. American employers, excluding farms, cut 651,000 jobs from their payrolls in February, bringing the total fall in employment in the past four months to 2.6m. There are now 12.5m people out of work, and a further 8.6m working part-time out of necessity rather than choice.

European industry continues to shrink. Britain's industrial production fell by 2.6% in January, the largest one-month drop for almost 20 years. Industrial production in France fell by 3.1% in January leaving it 13.8% lower than a year earlier. Orders for German manufacturing goods fell by 38% in the year to January. German exports fell by 20.7% over the same period.

China's investment spending was 26.5% higher in the first two months of this year than in the same period in 2008. The government is pouring money into infrastructure projects in an attempt to offset a slump in China's exports, which fell by 25.7% in the year to February.

Brazil's central bank cut its main interest rate by 1.5 percentage points, to 11.25%, on March 11th. On the same day **New Zealand's** central bank reduced its benchmark interest rate by half a percentage point, to 3%, a record low.

GDP in the **Czech Republic** rose by 0.7% in the fourth quarter of 2008.

Output, prices and jobs

Mar 12th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	-0.8 Q4	-6.2	-2.2	+1.9	-10.0 Jan	nil Jan	+4.3	-0.6	8.1 Feb
Japan	-4.3 Q4	-12.1	-5.3	+0.5	-30.8 Jan	nil Jan	+0.7	-0.8	4.1 Jan
China	+6.8 Q4	na	+6.0	+7.0	+3.8 Jan-Feb	-1.6 Feb	+8.7	-0.2	9.0 2008
Britain	-1.9 Q4	-6.0	-3.1	+0.5	-11.4 Jan	+3.0 Jan§	+2.2	+1.0	6.3 Dec††
Canada	-0.7 Q4	-3.4	-1.5	+1.7	-5.7 Dec	+1.1 Jan	+2.2	+0.5	7.2 Jan
Euro area	-1.3 Q4	-5.8	-2.4	+0.7	-12.0 Dec	+1.2 Feb	+3.3	+0.6	8.2 Jan
Austria	+0.5 Q4	-0.8	-1.3	+0.8	-4.7 Dec	+1.2 Jan	+3.2	+0.8	4.0 Jan
Belgium	-0.8 Q4	-6.5	-1.8	+0.9	-6.5 Dec	+1.9 Feb	+3.6	+1.1	11.2 Feb‡‡
France	-1.0 Q4	-4.6	-1.9	+0.7	-13.8 Jan	+0.9 Feb	+2.8	+0.4	8.3 Jan
Germany	-1.7 Q4	-8.2	-3.2	+0.8	-12.0 Dec	+1.0 Feb	+2.8	+0.4	7.9 Feb
Greece	+2.4 Q4	+1.2	-1.9	-0.3	-8.7 Dec	+1.6 Feb	+4.4	+0.9	7.8 Nov
Italy	-2.9 Q4	-7.5	-2.7	+0.5	-14.3 Dec	+1.6 Feb	+2.9	+1.0	6.7 Q3
Netherlands	-0.6 Q4	-3.4	-1.9	+0.8	-13.3 Dec	+2.0 Feb	+2.2	+0.7	3.9 Jan††
Spain	-0.7 Q4	-3.8	-2.5	nil	-23.6 Jan	+0.7 Feb	+4.4	+0.6	14.8 Jan
Czech Republic	+0.7 Q4	-3.7	-2.0	+1.6	-14.6 Dec	+2.0 Feb	+7.5	+1.8	7.4 Feb
Denmark	-3.9 Q4	-7.8	-2.2	+0.7	-9.2 Jan†††	+1.9 Feb	+3.1	+1.2	2.3 Jan
Hungary	+2.0 Q4	-3.9	-3.0	+0.4	-21.0 Jan	+3.0 Feb	+6.9	+2.9	8.4 Jan††
Norway	+0.8 Q4	+5.6	-1.0	+0.6	-0.6 Jan	+2.5 Feb	+3.7	+1.7	3.0 Dec***
Poland	+2.9 Q4	na	+0.7	+2.2	-14.9 Jan	+3.1 Jan	+4.0	+3.0	10.5 Jan‡‡
Russia	+1.1 Q4	na	-2.0	+3.0	-16.0 Jan	+12.0 Feb	+12.7	+13.0	8.1 Jan‡‡
Sweden	-4.9 Q4	-9.3	-2.2	+0.9	-22.9 Jan	+0.9 Feb	+3.1	-0.1	7.3 Jan‡‡
Switzerland	-0.1 Q4	-1.2	-1.6	+0.7	+0.7 Q3	+0.2 Feb	+2.4	-0.1	3.1 Feb
Turkey	+0.5 Q3	na	-1.5	+1.7	-21.3 Jan	+7.7 Feb	+9.1	+7.8	12.3 Q4‡‡
Australia	+0.3 Q4	-2.1	-0.3	+1.6	+3.8 Q3	+3.7 Q4	+3.0	+2.1	5.2 Feb
Hong Kong	-2.5 Q4	-7.8	-4.7	+0.2	-6.7 Q3	+3.1 Jan	+3.3	+1.1	4.6 Jan††
India	+5.3 Q4	na	+5.0	+6.6	-0.5 Jan	+10.4 Jan	+5.5	+5.4	6.8 2008
Indonesia	+5.2 Q4	na	+1.9	+2.2	-2.8 Dec	+6.9 Feb	+7.4	+5.5	8.4 Aug
Malaysia	+0.1 Q4	na	-0.3	+2.8	-20.2 Jan†††	+3.9 Jan	+2.3	+1.1	3.1 Q3
Pakistan	+5.8 2008**	na	+1.2	+3.2	-1.6 Dec	+21.1 Feb	+11.3	+10.1	5.6 2007
Singapore	-4.2 Q4	-16.4	-7.2	+1.8	-29.1 Jan	+2.9 Jan	+6.6	+0.4	2.6 Q4
South Korea	-3.4 Q4	-20.8	-5.9	+0.3	-25.6 Jan	+4.1 Feb	+3.6	-0.6	3.3 Jan
Taiwan	-8.4 Q4	na	-6.5	+0.1	-43.1 Jan	-1.3 Feb	+3.9	-1.0	5.3 Jan
Thailand	-4.3 Q4	-22.2	-1.8	+2.2	-21.3 Jan	-0.1 Feb	+5.4	-1.4	1.4 Dec
Argentina	+4.9 Q4	-1.2	-2.7	+1.7	-4.4 Jan	+6.8 Feb	+8.4	+7.0	7.3 Q4‡‡
Brazil	+1.3 Q4	-13.6	-0.4	+3.2	-17.2 Jan	+5.9 Feb	+4.6	+4.4	8.2 Jan‡‡
Chile	+4.8 Q3	-0.2	+0.4	+2.3	-8.9 Jan	+5.5 Feb	+8.1	+3.7	8.0 Jan††‡‡
Colombia	+3.1 Q3	+2.9	-1.0	+1.5	-9.2 Dec	+6.5 Feb	+6.4	+5.0	14.2 Jan‡‡
Mexico	-1.6 Q4	-10.3	-2.6	+1.4	-6.7 Dec	+6.2 Feb	+3.7	+4.8	5.0 Jan‡‡
Venezuela	+3.2 Q4	na	-3.0	-5.4	+2.4 Nov	+29.5 Feb	+25.4	+31.6	6.3 Q4‡‡
Egypt	+5.9 Q3	na	+3.9	+3.9	+7.3 Q3	+13.5 Feb	+12.1	+7.8	8.6 Q3‡‡
Israel	+1.2 Q4	-0.5	+0.4	+2.6	+1.2 Dec	+3.3 Jan	+3.5	+1.8	6.3 Q4
Saudi Arabia	+3.5 2007	na	+0.4	+3.3	na	+7.9 Jan	+5.8	+4.3	na
South Africa	+1.0 Q4	-1.8	-0.8	+3.1	-7.0 Dec	+8.1 Jan	+9.3	+6.0	21.9 Dec‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	-9.7 Q4	na	-5.0	+1.1	-26.8 Jan	+3.4 Feb	+11.3	+3.3	9.2 Dec
Finland	-2.4 Q4	-5.0	-2.8	+0.5	-19.5 Jan†††	+2.2 Jan	+3.9	+0.7	6.6 Jan
Iceland	-1.3 Q4	-3.6	-11.5	nil	+0.4 2007	+17.6 Feb	+6.8	+12.5	6.6 Jan‡‡
Ireland	+0.1 Q3	+4.7	-4.8	-1.4	-12.3 Dec	-0.1 Jan	+4.3	-0.7	10.4 Feb
Latvia	-10.3 Q4	na	-12.0	-2.0	-23.9 Jan	+9.6 Feb	+16.7	+3.0	10.4 Dec
Lithuania	-2.0 Q4	-5.1	-8.0	-2.5	na	+8.7 Feb	+10.7	+4.2	7.0 Jan‡‡
Luxembourg	-0.3 Q3	-5.5	-2.8	+0.1	-15.9 Nov	+0.5 Jan	+3.3	+0.5	5.5 Jan‡‡
New Zealand	-1.4 Q3	-2.7	-3.2	+0.5	-0.5 Q3	+3.4 Q4	+3.2	+1.6	4.6 Q4
Peru	+4.9 Dec	na	+3.1	+4.1	+3.9 Dec	+5.5 Feb	+4.8	+5.1	10.3 Jan††
Philippines	+4.5 Q4	+4.1	-0.6	+1.6	-15.4 Dec	+7.3 Feb	+5.4	+1.9	6.8 Q4‡‡
Portugal	-1.8 Q4	-6.2	-2.8	-0.7	-19.1 Jan	+0.2 Feb	+2.9	-0.5	7.8 Q4‡‡
Slovakia	+2.5 Q4	na	+2.0	+2.8	-27.0 Jan	+3.1 Feb	+4.0	+2.8	9.0 Jan‡‡
Slovenia	-0.8 Q4	na	+0.5	+1.5	-17.5 Dec	+2.1 Feb	+6.5	+1.4	7.0 Dec‡‡

*% change on previous quarter, annual rate. † *The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡ National definitions.- § RPI inflation rate 0.1% in Jan. **Year ending June. †† Latest three months. ‡‡ Not seasonally adjusted. ***Centred 3-month average ††† New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Mar 12th 2009
From The Economist print edition

The Economist commodity-price index

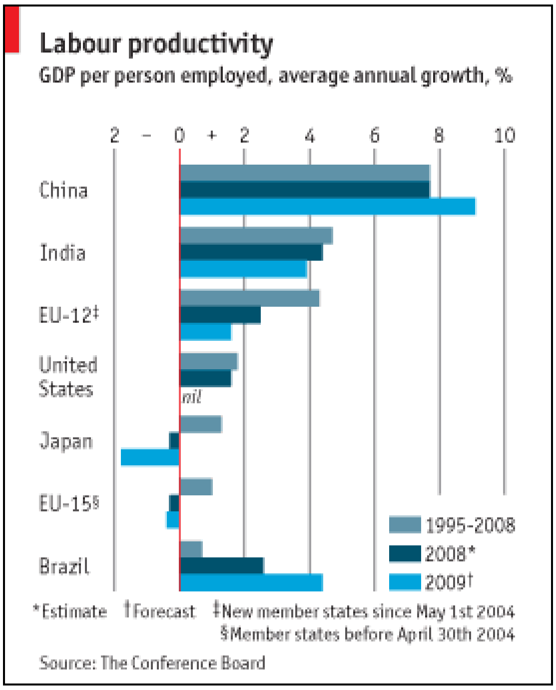
2000=100

	Mar 3rd	Mar 10th*	% change on one month	% change on one year
Dollar index				
All items	149.7	153.3	-5.0	-43.2
Food	174.6	178.7	-6.0	-34.1
Industrials				
All	117.5	120.5	-3.1	-55.2
Nfa†	105.6	104.6	-8.9	-45.4
Metals	124.0	129.1	-0.2	-58.4
Sterling index				
All items	161.6	167.9	+0.8	-17.8
Euro index				
All items	110.1	111.2	-2.9	-31.8
Gold				
$ per oz	909.40	894.20	-2.0	-8.3
West Texas Intermediate				
$ per barrel	41.32	45.71	+20.7	-57.9

*Provisional †Non-food agriculturals.

Labour productivity

Mar 12th 2009
From The Economist print edition



Growth in global productivity, measured as output per person in work, fell to 2.2% in 2008, according to the Conference Board, a business-research firm. It expects labour-productivity growth to drop to just 1.4% this year. The most dramatic declines are likely to be in rich countries. Labour productivity is expected to stagnate in America, following growth of 1.6% last year. Productivity in Japan is set to decline by 1.8%. It is likely to fall in "old Europe" (the EU excluding its newest members) as well. The outlook for the biggest emerging economies is more encouraging. Chinese labour productivity is expected to rise to 9.1% in 2009, up from 7.7% last year. Brazil's productivity growth is forecast to pick up to 4.4%.

Trade, exchange rates, budget balances and interest rates

Mar 12th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Mar 11th	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−820.6 Dec	−697.9 Q3	−3.3	–	–	−11.1	0.44	2.91
Japan	+28.5 Jan	+143.3 Jan	+2.0	97.7	102	−5.4	0.57	1.31
China	+311.5 Feb	+400.7 Q2	+6.1	6.84	7.10	−3.6	1.26	3.15
Britain	−173.0 Dec	−45.6 Q3	−2.0	0.73	0.49	−11.3	1.93	3.09
Canada	+45.8 Dec	+19.2 Q3	−1.1	1.28	0.99	−2.4	0.44	3.09
Euro area	−46.4 Dec	−89.6 Dec	−0.8	0.78	0.65	−4.6	1.70	3.07
Austria	−2.4 Dec	+16.8 Q3	+1.6	0.78	0.65	−3.4	1.66	4.26
Belgium	+7.1 Dec	−8.2 Sep	+0.7	0.78	0.65	−3.6	1.69	4.09
France	−80.6 Jan	−56.1 Dec	−2.2	0.78	0.65	−5.4	1.66	3.70
Germany	+250.7 Jan	+224.3 Jan	+5.3	0.78	0.65	−3.9	1.66	3.06
Greece	−67.0 Nov	−51.2 Dec	−12.2	0.78	0.65	−4.8	1.66	5.75
Italy	−16.6 Dec	−72.9 Dec	−2.0	0.78	0.65	−4.3	1.66	4.51
Netherlands	+52.7 Dec	+67.6 Q3	+6.2	0.78	0.65	−1.3	1.66	3.71
Spain	−139.3 Dec	−154.5 Dec	−7.8	0.78	0.65	−7.4	1.66	3.84
Czech Republic	+3.8 Jan	−6.6 Dec	−2.3	21.2	16.2	−3.0	2.49	5.02
Denmark	+5.6 Dec	+6.8 Jan	+1.0	5.83	4.81	−0.8	3.26	3.72
Hungary	nil Dec	−11.3 Q3	−3.7	235	167	−2.7	9.52	11.60
Norway	+76.3 Jan	+83.4 Q4	+9.8	6.94	5.11	9.7	3.22	3.84
Poland	−23.7 Dec	−28.5 Dec	−4.9	3.60	2.28	−2.2	4.35	6.09
Russia	+170.8 Jan	+98.9 Q4	−3.3	35.1	23.7	−6.1	13.00	11.41
Sweden	+15.7 Jan	+40.3 Q4	+6.7	8.79	6.08	−3.3	0.41	2.86
Switzerland	+19.2 Jan	+40.3 Q3	+8.7	1.16	1.02	−1.7	0.46	2.12
Turkey	−65.7 Jan	−37.2 Jan	−3.4	1.74	1.22	−3.0	12.80	9.56‡
Australia	−1.0 Jan	−44.1 Q4	−5.3	1.54	1.07	−3.1	3.10	4.33
Hong Kong	−24.1 Jan	+26.4 Q3	+9.5	7.76	7.79	−3.7	0.96	1.88
India	−111.2 Jan	−28.5 Q3	−3.9	51.9	40.3	−6.1	4.65	7.25
Indonesia	+8.0 Jan	+3.9 Q3	+0.2	11,978	9,160	−2.9	9.35	11.02‡
Malaysia	+42.2 Jan	+38.3 Q3	+7.8	3.70	3.18	−6.6	2.09	3.79‡
Pakistan	−19.7 Feb	−15.6 Q3	−5.8	80.3	62.8	−6.4	11.95	22.59‡
Singapore	+16.1 Jan	+27.1 Q4	+14.0	1.53	1.39	−4.1	0.63	1.99
South Korea	−7.8 Feb	−5.0 Jan	+1.2	1,471	971	−3.5	2.44	4.83
Taiwan	+6.3 Feb	+25.0 Q4	+7.9	34.5	30.7	−5.0	0.90	1.50
Thailand	+1.7 Jan	−1.3 Jan	−0.2	36.0	31.6	−4.2	1.82	2.99
Argentina	+12.8 Jan	+9.0 Q3	−0.8	3.64	3.15	−0.8	14.44	na
Brazil	+24.2 Feb	−27.0 Jan	−2.2	2.34	1.68	−1.5	12.66	6.16‡
Chile	+7.6 Feb	−1.6 Q3	−3.4	601	432	−3.5	3.48	3.93‡
Colombia	+2.0 Dec	−5.3 Q3	−4.0	2,507	1,851	−3.3	8.59	7.35‡
Mexico	−16.6 Jan	−2.4 Q4	−3.4	15.2	10.8	−3.2	7.91	8.51
Venezuela	+39.2 Q4	+39.2 Q4	+0.2	5.75	5.00§	−5.2	17.06	6.55‡
Egypt	−25.2 Q3	+0.1 Q3	−1.0	5.68	5.46	−7.1	10.70	4.20‡
Israel	−13.1 Jan	+2.6 Q3	+1.9	4.20	3.46	−5.0	0.48	3.69
Saudi Arabia	+150.8 2007	+95.0 2007	−7.9	3.75	3.75	−8.0	1.15	na
South Africa	−8.7 Jan	−23.2 Q3	−7.0	10.1	7.83	−3.3	9.78	8.32
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−3.6 Dec	−2.2 Dec	−4.2	12.2	10.1	−3.4	7.15	na
Finland	+10.1 Dec	+6.7 Dec	+2.4	0.78	0.65	−4.1	1.63	3.83
Iceland	+0.1 Feb	−5.6 Q4	−4.9	111	68.9	−12.6	18.13	na
Ireland	+43.4 Dec	−16.4 Q3	−1.7	0.78	0.65	−12.4	1.66	5.82
Latvia	−6.4 Dec	−4.5 Dec	−5.0	0.55	0.45	−6.0	10.30	na
Lithuania	−6.6 Dec	−6.3 Dec	−7.5	2.70	2.23	−2.5	7.00	na
Luxembourg	−7.9 Jan	+4.0 Q3	na	0.78	0.65	−3.9	1.66	na
New Zealand	−3.6 Jan	−11.6 Q3	−6.3	1.98	1.24	−6.3	3.65	4.62
Peru	+2.6 Jan	−4.2 Q4	−4.1	3.17	2.81	−1.9	6.10	na
Philippines	−7.6 Dec	+2.9 Sep	+2.9	48.4	41.3	−2.6	5.00	na
Portugal	−34.0 Dec	−29.3 Dec	−7.7	0.78	0.65	−4.5	1.66	4.51
Slovakia	−0.9 Dec	−6.2 Nov	−4.8	23.6	20.9	−2.8	1.35	4.31
Slovenia	−4.7 Dec	−3.1 Dec	−4.9	0.78	0.65	−3.3	1.66	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Mar 12th 2009
From The Economist print edition

Markets

	Index Mar 11th	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	6,930.4	+0.8	−21.0	−21.0
United States (S&P 500)	721.4	+1.2	−20.1	−20.1
United States (NAScomp)	1,371.6	+1.3	−13.0	−13.0
Japan (Nikkei 225)	7,376.1	+1.2	−16.7	−22.8
Japan (Topix)	722.3	−1.3	−15.9	−22.0
China (SSEA)	2,245.3	−2.7	+17.4	+17.1
China (SSEB, $ terms)	139.9	−0.2	+26.4	+26.1
Britain (FTSE 100)	3,693.8	+1.3	−16.7	−20.2
Canada (S&P TSX)	8,011.0	+2.5	−10.9	−14.1
Euro area (FTSE Euro 100)	596.5	−0.4	−20.1	−26.6
Euro area (DJ STOXX 50)	1,932.8	−0.5	−21.0	−27.4
Austria (ATX)	1,450.1	−3.5	−17.2	−23.9
Belgium (Bel 20)	1,649.0	+4.1	−13.6	−20.6
France (CAC 40)	2,674.2	−0.1	−16.9	−23.6
Germany (DAX)*	3,914.1	+0.6	−18.6	−25.2
Greece (Athex Comp)	1,538.2	+2.0	−13.9	−20.9
Italy (S&P/MIB)	13,568.0	−5.5	−30.3	−35.9
Netherlands (AEX)	210.3	−0.6	−14.5	−21.4
Spain (Madrid SE)	758.3	−2.1	−22.3	−28.6
Czech Republic (PX)	675.6	+4.5	−21.3	−28.2
Denmark (OMXCB)	205.2	−1.2	−9.3	−16.7
Hungary (BUX)	9,735.9	−3.0	−20.5	−35.3
Norway (OSEAX)	254.3	−0.1	−5.9	−5.1
Poland (WIG)	23,232.4	+2.3	−14.7	−29.9
Russia (RTS, $ terms)	627.6	+11.5	+14.0	−0.7
Sweden (Aff.Gen)	195.1	+3.7	−1.1	−11.1
Switzerland (SMI)	4,577.0	+2.5	−17.3	−24.0
Turkey (ISE)	23,282.6	−2.7	−13.3	−23.2
Australia (All Ord.)	3,199.1	+2.3	−12.6	−19.4
Hong Kong (Hang Seng)	11,930.7	−3.2	−17.1	−17.1
India (BSE)	8,160.4	−3.4	−15.4	−20.5
Indonesia (JSX)	1,314.5	+1.9	−3.0	−11.7
Malaysia (KLSE)	850.4	−1.9	−3.0	−9.2
Pakistan (KSE)	5,557.9	−4.4	−5.2	−6.6
Singapore (STI)	1,505.5	−2.5	−14.5	−19.6
South Korea (KOSPI)	1,127.5	+6.4	+0.3	−14.1
Taiwan (TWI)	4,760.0	+4.8	+3.7	−1.4
Thailand (SET)	414.4	−0.8	−7.9	−11.0
Argentina (MERV)	1,004.3	+1.8	−7.0	−11.8
Brazil (BVSP)	38,804.0	+1.0	+3.3	+3.1
Chile (IGPA)	11,691.2	−0.4	+3.2	+9.5
Colombia (IGBC)	7,735.4	−0.4	+2.3	−8.3
Mexico (IPC)	17,790.7	−0.2	−20.5	−27.4
Venezuela (IBC)	37,685.5	+0.8	+7.4	+15.6
Egypt (Case 30)	3,712.8	+4.3	−19.2	−21.6
Israel (TA-100)	590.4	−0.7	+4.7	−5.8
Saudi Arabia (Tadawul)	4,130.2	−5.0	−14.0	−14.0
South Africa (JSE AS)	19,120.0	+3.5	−11.1	−19.0
Europe (FTSEurofirst 300)	692.7	−0.5	−16.7	−23.5
World, dev'd (MSCI)	731.0	+1.2	−20.6	−20.6
Emerging markets (MSCI)	512.5	+3.9	−9.6	−9.6
World, all (MSCI)	183.2	+1.5	−19.5	−19.5
World bonds (Citigroup)	754.8	+1.4	−6.8	−6.8
EMBI+ (JPMorgan)	385.6	+0.3	−1.5	−1.5
Hedge funds (HFRX)‡	1,026.8	+0.2	+0.6	+0.6
Volatility, US (VIX)	43.6	47.6	40.0	(levels)
CDSs, Eur (iTRAXX)†	192.8	−0.2	−4.6	−12.3
CDSs, N Am (CDX)†	273.9	+1.0	+17.3	+17.3
Carbon trading (EU ETS) €	11.7	+0.8	−27.7	−33.5

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡Mar 10th

The cost of living

Mar 12th 2009
From The Economist print edition

Sharp exchange-rate movements since the autumn have affected the relative cost of living in the world's main cities. The strengthening dollar has pushed American cities up in the rankings compiled by the Economist Intelligence Unit, a sister company of *The Economist*. Chicago now shares the ranking as the world's 23rd most expensive city, up from 39th place in September 2008. Meanwhile, the plunging pound means that, for the first time since 2002, London is cheaper than New York. Asia is home both to the cheapest city in the survey, Karachi, as well as the priciest, Tokyo, which has grabbed the top spot from Oslo on the back of a stronger yen. Living in Tokyo is 52% more expensive than living in New York.